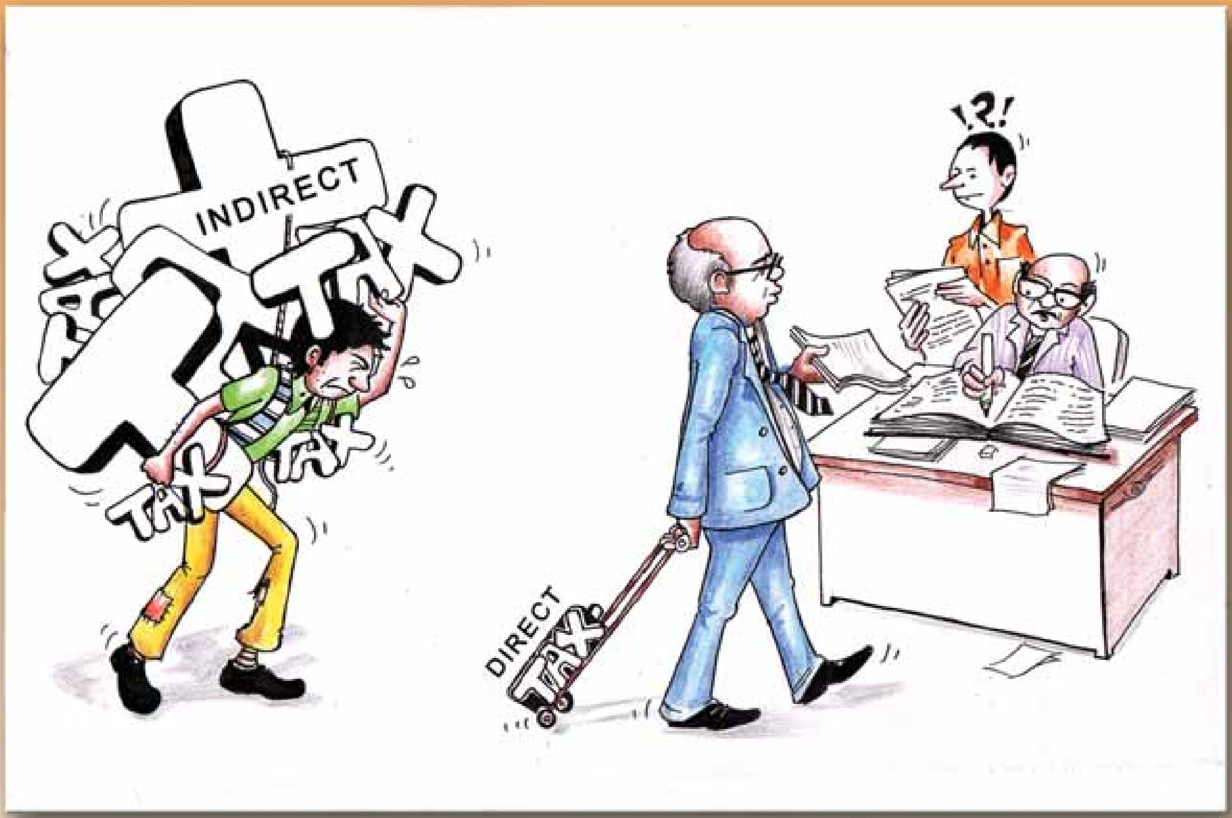
Budget TRACK

Volume 8, Track 3, July 2012

IN THIS ISSUE



A Publication by Centre for Budget and Governance Accountability
CBGA

Budget TRACK

Volume 8, Track 3 July 2012

IN THIS ISSUE

Centre for Budget and Governance Accountability
B-7 Extension/110A (Ground Floor)
Harsukh Marg, Safdarjung Enclave
New Delhi - 110029. INDIA
Tel: (11) 4920 0400
Telefax: 4050 4846
Email: info@cbgaindia.org
Web: www.cbgaindia.org

Foreword

Echoing Nobel laureate Amartya Sen's view that development is eventually about '*freedom*' –i.e. to be able to choose one's life course and the capability to enjoy that freedom - we feel the need to redefine government's policies and make them more progressive is critical to attainment of such a *freedom* for a majority of peoplein the country. Not only is this attainment of *freedom* by most of the Indians feared by those in authority as it is seen as inhibiting their power, it also perpetuates in what Prof.Sen terms as '*unfreedoms*' or injustices for others. It thus becomes necessary to interrogate government policies from this lens of *freedom* and challenge the prevalence of *unfreedoms* by way of questioning the skewed policy priorities adopted by the government.

Since inception, CBGA has been working towards advocating for a more equitable and progressive policy paradigm seeking increased government spending in critical sectors such as education, health, water, sanitation, food security and so on, in keeping with our understanding that the withdrawal of the state from provisioning of these basic entitlements would have deleterious consequences in the long run. We also believe that undeterred private sector involvement in planning, provisioning and implementing services pertaining to critical sectors such as health and education among others would only push us farther from attaining any of our avowed commitments. In this regard, a common refrain from the policymakers is the question of resources to spend on these sectors. It is clearly time for NGOs, think tanks and civil society activists to advocate for more progressive tax policies for the country.

The first and foremost concern is that the magnitude of the country's tax revenue as compared to the size of the economy, measured in terms of the tax-GDP ratio, is abysmally low. At 14.7 per cent, it is lower than the tax-GDP ratio in countries like Senegal (16.1 per cent), South Africa (31.2 per cent), Turkey (32.5 per cent) and Brazil (34.2 per cent). Only if this ratio for India increases significantly, public spending can be increased adequately for key sectors. It is also pertinent to note that the government continues to willingly forego a huge proportion of tax revenue by way of giving exemptions, tax holidays and concessions to corporations; doing away with such exemptions is necessary.

The interlinked issues of tax evasion and tax avoidance by companies as they find ever newer ways to not pay their due share of taxes is an area of growing concern as is evident from the recent judicial and media scrutiny on several cases. Another related aspect is deconstructing the myth that it is only the upper and middle income groups that pay tax; data shows that the poor also pay tax and the share of indirect taxes (wherein the burden of tax can be shifted / passed on to people and which applies to the rich and the poor alike) is as much as two-third in the overall Indian tax system.What is needed is a re-jig of the tax structure with more focus on direct taxes and advocating for higher income groups to pay more taxes. Further, looking at the gender implications of tax policies is another vital aspect.

In our attempt to engage with the revenue / tax side of the budgets over the past couple of years, we have realised that such attempts will not find fruition unless there is adequate mobilisation and support from among the civil society, particularly the grassroots organisations, and other stakeholders like the academia, the media and the legislators to work towards a more progressive, equitable and just tax system in the country. This has led us to bring out this special issue of Budget Track focused on the key concerns relating to taxation in India. In keeping with this, we have an interesting mix of contributions that look at some of the critical aspects.

To begin with, Jayati Ghosh shares the case of Ecuador that has successfully been able to increase the tax collections significantly and step up public provisioning in some important areas making one wonder why cannot India do it if Ecuador can. Two new major policy reforms in India's tax system are on the anvil - introduction of the Goods and Services Tax (GST) and the Direct Taxes Code (DTC), which need to be understood and discussed widely. Mahesh Purohit examines the GST provisions and looks at the recent Budget proposals in this regard. This is followed by an interesting analysis of the DTC by Vinod Vyasulu who looks at some of its provisions and raises fundamental questions, all in verse! Amitayu Sen Gupta in his article outlines why we need to bother about tax havens and what they are all about. This is elaborated further in Matti Kohonen's comprehensive analysis of how to tackle tax havens.

As there is a lot of talk about innovative mechanisms to finance development, Ram Kishan in his piece focuses on one of these mechanisms – the Financial Transaction Tax (FTT). This is followed by Neha Hui's mapping of the Indian tax structure in which she looks at tax-GDP ratio, the lack of progressivity of India's tax system and so on. In his piece, Sankhanath Bandyopadhyay takes us through the world of tax exemptions and shares some of the key concerns. This is followed by Pooja Rangaprasad elaborating on the Vodafone case as an instance of the need for plugging the loopholes in the country's tax policies pertaining to cross-border transactions. Another piece by Pooja Rangaprasad briefly notes the key features of a relevant White Paper released recently by the Union Ministry of Finance on the issue of Black Money. Our usual Budget and Policy Tracking article maps the key policy developments pertaining to three sessions of Parliament – Monsoon and Winter session of 2011 and Budget session of 2012.

We hope you would enjoy reading this issue as much as we liked putting it together!

CBGA Team

Expanding the Fiscal Space through Taxation: Lessons from Ecuador

Jayati Ghosh*

All too often, when citizens of India (and, to be fair, many other developing countries) demand increases in public spending that would go some way towards ensuring their social and economic rights, they are told that there is simply no fiscal space for this. "Where is the money?" is the usual response. It is no matter that the demands are for essential public provision that every civilised society must provide for its people, such as minimum food and shelter entitlements, health and sanitation, education, and so on. The basic perception is that even if increasing such spending is desirable it is unfortunately a luxury the country cannot afford given the global concern on fiscal consolidation and the difficulty (if not near impossibility) of raising tax revenues.

Two fiscal myths have been perpetuated in this regard. First, that fiscal consolidation [in the form of reducing public deficits and bringing down public debt to gross domestic product (GDP) ratios] is always the preferred strategy, regardless of the cyclical conditions of the economy. Second, and perhaps more significant, that fiscal austerity in the form of cutting public spending is the only way to achieve such consolidation. Both myths deserve to be broken.

In particular, the idea that globalisation and particularly cross-border mobility of capital have meant that governments cannot afford to raise tax revenues has got deeply implanted in the minds of policymakers across the world. It is, in fact, a completely false argument. The extent of the falsity is shown clearly in a powerful counter-example coming from Ecuador, a small country that is usually described as having little or no policy space.

Until recently, Ecuador was very much a banana republic exporting primary products (oil and agricultural products) and people (migrants to the United States) but still running balance of payments deficits and prone to instability in a context of economic inequality, widespread poverty and backwardness. Dollarisation of the economy curbed the hyperinflation but did not resolve any of the systemic problems, and the economy continued to lurch from crisis to crisis combined with rapid political changeovers. From 2007, however, the government led by Rafael Correa has attempted to change many of these features, and the extent of its success in a relatively short time is remarkable.

One of the most impressive changes has been in the area of tax collection. Ecuador is an oil exporter (only of crude oil, however, since it does not have domestic processing facilities), and any increase in public revenues is commonly attributed to the increase in global oil prices. That has indeed been important, not least because the Correa government has successfully renegotiated the terms of its contracts with multinational oil companies.

Thus, whereas in the past the government received only an average of 13 per cent of the gross sales value of the oil, it now gets as much as 87 per cent. Despite this major switch, more than half of the foreign oil companies continue to operate in the country, which is a sign of the massive surplus profits that were accruing to them earlier. In any case, this has meant that the government has been able to benefit much more substantially from higher global oil prices. Incidentally, while this led to substantially increased hydrocarbon royalties for the state, it also meant lower tax revenues from this source.

But what is extraordinary is that, despite this very large increase, the public exchequer has actually reduced its dependence on oil during the Correa regime. The share of oil revenues in total government revenues has come down from 30.4 per cent in the period 2001-05 to only 26.1 per cent in 2006-10 – in other words, non-oil revenues now account for nearly three-quarters of government revenues.

This is mainly because of a massive effort towards efficient tax collection, which has caused tax revenues to more than double in five years. Total tax collection rose from $4.67 million in 2006 to $9.56 million in 2011. As a result, direct taxes – mainly corporation taxes – account for more than 40 per cent of the government's revenue collection, up from around 35 per cent.

This is hugely important because it shows that this is something all governments can do, if only there is the political will to do so. Remarkably, the government did this without any adverse effects on either the rate of investment (which kept increasing over the period and is now a healthy 26 per cent of GDP) or the aggregate growth rate (expected to be as high as 8 per cent in 2011). So the usual arguments against such a drive – that it will affect "investor confidence" and therefore investment – have clearly not been relevant.

What exactly did the Correa government do to ensure this direct tax increase? Carlos Marx Carrasco, the head of the Internal Revenue Service (SRI), argues that this success is due primarily to better enforcement, collection of tax arrears and

* Prof. Jayati Ghosh teaches Economics at Jawaharlal Nehru University, New Delhi; she is the Executive Secretary of International Development Economics Associates (IDEAS), and is a co-founder of Economic Research Foundation, New Delhi. She is a columnist for a number of journals and newspapers, member of the National Knowledge Commission and she has been involved with several progressive organisations and social movements. She is also a member of CBGA's Board of Trustees. The present article first appeared in the Jan 28-Feb 10 issue of Frontline and can be accessed at Vol:29 Iss:02. URL: http://www.flonnet.com/fl2902/stories/20120210290209800.htm

reduction of tax avoidance, which in turn has only been possible because of breaking the cosy political nexus that existed between the tax administration and the large businesses that reaped most of the benefits of domestic economic growth.

The SRI achieved this through the systematic use of information technology and the introduction of more detailed reporting requirements for companies, combined with strict measures to punish tax evaders. Since April 2006, the SRI has required companies to submit a range of detailed information on monthly value-added tax (VAT) filings, financial yields, credit-card movements and income tax withholdings. Despite complaints from businesses about the time taken and difficulty in filling out these forms, they have proved to be very useful in curbing tax evasion. The SRI has used the information to monitor exports, imports, purchases, sales, voided receipts and withholdings in general. This has allowed it to come up with much more systematic (and higher) estimates of the revenues due to it.

Once these estimates have been made, companies have been forced to pay up their taxes and the estimated arrears. Commercial outlets and private professional offices of proven tax evaders in most main cities have been shuttered until they have met their tax obligations. The process is still only partially complete, and the SRI estimates that there is much more potential to increase tax revenues through further tightening and better compliance. The stick of more stringent and effective enforcement has been combined with the carrot of lower rates – corporation tax rates are to be lowered to 22 per cent from the current 25 per cent.

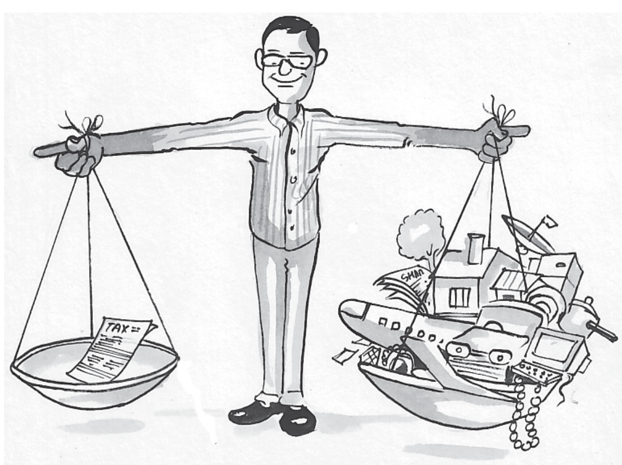
These increased revenues – both from oil royalties and from tax collection – have been directed towards increased social spending and public investment. Ecuador now has the highest rate of public investment (10 per cent of GDP) in the Latin American region. In addition to spending on much-needed physical infrastructure, an important part of this has been devoted to public housing. In the period 2007-09, the housing deficit was reduced as more than 200,000 homes were handed over to the public. The number of homes with a sewage system increased from 2.78 million in 2006 to 3.33 million in 2010, which is more than two-thirds of urban households.

Social spending has also doubled, from 5 to 10 per cent of GDP between 2006 and 2011. Much of this has gone towards increases in public employment in activities such as health, sanitation and education and in ensuring that all public sector workers are part of the formal employment sector, with minimum wages and proper regulated working conditions, rather than working in subcontracted companies. (Incidentally, this move, along with enforcement of social security and labour laws, has had a knock-on positive effect in the labour market in general. Even in the private sector, formal employment has increased and informal employment has fallen – in sharp contrast to trends in most of the rest of the world.)

Investment in health has increased by 129 per cent, driven also by the requirement of the 2008 Constitution that all citizens have access to free health care. Education is also to be available free at all levels, and the education budget has more than tripled, from \$235 million over 2003-06 to \$941 million in 2007-10.

So it can be done, after all. Tax revenues can be increased, by enforcing proper tax collection and cracking down on evasion. Big companies – both domestic and multinational – can be disciplined without adversely affecting investment or GDP growth. The increased public revenues can be used for more public provision in necessary areas to ensure the social and economic rights of citizens. All this is clearly possible, even for a small country operating with several constraints in the globally integrated world.

This is a message that must reach policymakers everywhere, especially in India where the general attitude towards both revenue mobilisation and social spending is defeatist and conservative in the extreme. Even more, this message should reach people everywhere so that they can create much more public pressure to achieve what turns out to be eminently doable.



Inching Towards GST

*Mahesh C Purohit**

The Union Budget presented on March 16, 2012 was an effort at fiscal consolidation within the constraints of the economic downturn during a financial year with a low growth rate of 6.9 per cent. Given the scenario, the major indirect tax reforms proposed in this budget aims at boosting economic growth in the country through mobilisation of additional resources and reducing the fiscal deficit. A few steps have nevertheless been taken to move closer to the introduction of Goods and Services Tax (GST).

One of the important reforms proposed in Union Budget 2012-13 relates to the adoption of a negative list of services instead of taxation of a few select services. It is a well-known fact that from among the two methods of taxation of services in vogue, viz., notifying services to be taxed (positive list) and notifying services to be tax-exempt (negative list), most countries follow the latter system. However, so far, India has followed the former approach due to the fact that service tax has historically followed an incremental pattern, and has included more and more services within the tax net over the years.

This approach of notifying services to be taxed (positive list) has outlived its purpose. Continuing with this approach would have made the list very lengthy and complicated. Also, it would invite innumerable litigations and have many interpretational problems. A comprehensive service tax with a small negative list is, therefore, a welcome step for paving the way for GST.

However, it is important to keep in mind that the present proposal is only a step forward towards the introduction of GST; it presupposes continuance of CenVAT (Central Value Added Tax) as well as State-VAT. Hence, it would be in the best interest of the federal structure of the country to leave out those services that are listed exclusively in the State List. However, the current budget has brought some of the services into tax net that are, at present, exclusively in the State List. This would affect the spirit of cooperative federalism – the framework within which the Empowered Committee of the State Finance Ministers and the Central government work.

Exempting the services belonging exclusively to the states is easy because apart from the negative list, the Finance Minister has proposed a list of services exempted from tax. The current list includes services provided by charities, religious persons, sports persons, performing artistes in folk and classical arts, individual advocates providing services to non-business entities, independent journalists and services by way of animal care or car parking. Recognising the contribution of the film industry to the Indian society, in its centenary year, the budget has proposed to exempt the film industry from the levy of service tax on temporary transfer, permitting the use or enjoyment of a copyright for cinematographic films.

In spite of the fact that exemption of some services would be useful from the point of view of the economic or social or administrative aspect of tax administration, inclusion of many services in the negative list or in the exempt list would mean that no credit would be available for the tax charged on their inputs. Given the value-added structure of the tax, this would cause "tax cascading" through blockage of tax credits on inputs that go in the production of exempted services. At the same time, it would result in blocked input tax embedded in the cost of the services provided, and this can lead to a regressive outcome. If relief is to be provided, it should be in the form of zero-rating (i.e., no tax on output and full credit for input taxes), and not through tax exemption. A low rate of tax on the services in the nature of merit goods – with a very small list of exempted items and zero-rating of basic health and educational services – may be a better option.

More importantly, the indirect tax reforms such as the changes in abatement rates for increasing the service base of taxable value, synchronisation of service tax and central excise compliance procedures, expanding the eligibility of CenVAT credit for various sectors in order to reduce the cascading effect of taxes and changes to rationalise the "Point of Taxation Rules" indicate a steady movement towards GST.

The second important reform mentioned in the budget relates to making operational a strong information technology infrastructure for proper functioning of GST. In this context, the Finance Minister announced that the management information system for GST, known as GST Network (GSTN), will be operational by August 2012. This would be a landmark development in the management of GST. The Finance Minister announced that the structure of GSTN, already approved by the Empowered Committee of State Finance Ministers, will implement common PAN-based registration, returns filing and payments processing for all States on a shared platform. The use of PAN (Personal Identification Number) as a common identifier, in both direct and indirect taxes, will enhance transparency and check tax evasion. However, nothing special has been proposed in the budget to accomplish this task. This has been an ongoing project planned earlier.

Another major reform in the indirect system pertains to the Constitution (115th Amendment) Bill. The Finance Minister pointed out in his Budget Speech that to operationalise GST, the Constitution (115th Amendment) Bill has been introduced in the Lok Sabha in March

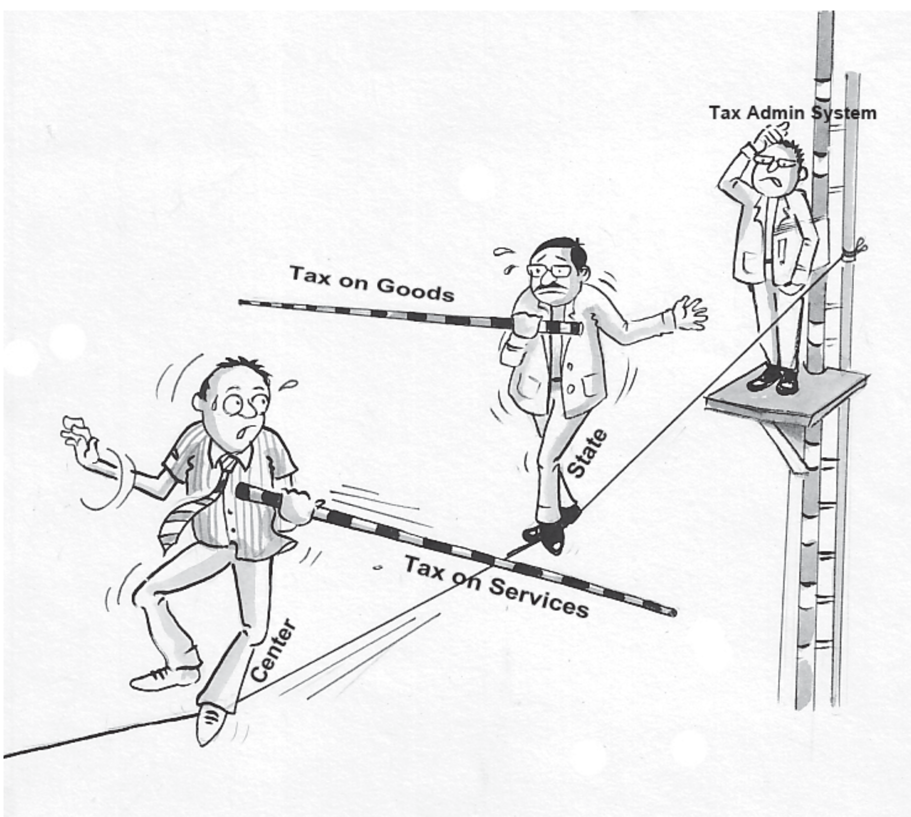
*Dr. Mahesh Purohit is Director of the Foundation for Public Economics and Policy Research, New Delhi, and was Member-Secretary of the Empowered Committee of State Finance Ministers on sales tax reforms. He has been a visiting professor at *Maison Des Sciences De L'Homme*, Paris, Institute of Fiscal and Monetary Policy, Tokyo, and International Tax Programme, Harvard Law School, Cambridge, Massachusetts, (USA).

2011 to enable Parliament and State legislatures to make laws for levying GST.

The Bill seeks to empower the President to set up a GST Council with the Union Finance Minister as chairperson and the Union Minister of State for Revenue and Finance Ministers of all the states as members. The GST Council will work on the basis of consensus and make recommendations on issues like GST rates, exemption lists, and threshold limits. Further, the Bill provides for setting up of a GST Dispute Settlement Authority, comprising a chairperson and two members to resolve disputes arising out of deviations from the recommendations of the GST Council, either by the Centre or the state governments. Unfortunately, the Finance Minister did not mention in his Budget Speech the disagreement of the states on these issues that is creating an impasse in its passage by Parliament.

It is felt that it would be more in tune with the spirit of co-operative federalism if the states are taken into confidence and some changes are incorporated into the Bill before it is finally brought for discussion. The major points of disagreement relate to the composition of the proposed GST Council and the Dispute Settlement Authority. There is nothing in the present budget on this issue. The states want to have a council which defines the structure before the Bill is passed and the same should provide equal authority to them. To remove this deadlock and to get the GST ball rolling, it is suggested that the GST Council be constituted on the pattern of the present Empowered Committee (EC) on GST, which has had an excellent track record of reforming the tax system over the last decade. Accordingly, the proposed Council should comprise the Union Finance Minister and all the Finance Ministers of States and the Union Territories as its members. However, unlike the present EC, which is a "society", registered under the Societies Registration Act, it should be a Constitutional body and should have a defined regulatory authority with strict punitive powers.

Finally, the Finance Minister in its Budget Speech claimed that the changes in the rates of excise duty and service tax – the taxes that would be subsumed in GST – have been made to bring these closer to GST. With regard to the Central Excise duty, the rate of tax has been increased from 10 to 12 per cent on non-petroleum products, the merit rate has increased from 5 to 6 per cent and the low rate of 1 per cent is levied on 130 items has been increased to 2 per cent with a few exceptions. However, it is felt that these changes are primarily meant for mobilising additional resources and have nothing to do with bringing them closer to GST. In fact, in any scenario of GST rates, whether given by the Empowered Committee or by the Central government or by the 13th Finance Commission, the GST rate would not be at the higher level of 12 per cent as proposed in this Union Budget. If these rates were to be in conformity with the GST model, the rates should have been brought down to 8 per cent rather than increasing them to the 12 per cent higher level.



An Ode to the Direct Tax Code

Vinod Vyasulu*

1
There is much noise in India about the
Proposed Direct Tax Code.
Industry is lobbying for it
Vigorously and Relentlessly.
Business channels on TV have deified it
As Essential and Urgent Reform.
The debate is confined to a comparison
Of tax provisions between the existing
Income Tax Act of 1961 and the proposals
In the new fangled DTC.
The DTC offers favourable tax treatment
And everyone loves it for that.
Many of them have been accepted and
Incorporated into existing practice.
In the last 20 years, tax rates have been
Reduced on the Laffer Curve example:
Lower rates mean more revenue.
We were promised that the many exemptions
That made income tax law unwieldy
Would go as rates went down.
The rates came down
The exemptions remain.
Business channels dont point this out
Industry lobbies dont complain.
Happiness reigns supreme.

2
Acts are laws on specific subjects.
Enacted codes are broader. They deal with
All related aspects of a subject
In a systematic and consistent manner
Based on logic and clarity.
India has the Code of Criminal Procedure.
France still has laws that are
Based on the Napoleonic Code of old
It gave their democracy a clear Vision.
There will be little Discretion
And hence low Corruption.
So replace the Income Tax Act with
The proposed Direct Tax Code.
Industry lobbies support it
As clearly they benefit from it.

3
But what about Indian Society?
Who is there to speak for it?
How many laws will the DTC replace?
And what is the underlying philosophy
That lies behind this DTC?
Is this DTC enough for development?
Dont we also need a Code of Government Expenditure?
Or is that another story?
What does the DTC mean for the *aam aadmi*?
Should we not debate it openly?

4
This Direct Tax Code is based on
Supply Side Economics.
High Tax rates punish business success.
Low tax rates encourage compliance
It is not worth paying for Tax Avoidance.
It will encourage economic growth.
The new Direct Tax Code will effectively
Freeze the tax system for business.
It will Reduce Uncertainty
And Increase Business Confidence
This is Good for the Country.

5
Yes, Codes like Acts can surely
Be amended by Parliament.
It is not easy to amend a Code
A change in one section will lead
To distortions in others
Because of its underlying logic.
Look at the existing
Criminal Procedure Code
It makes homosexuality criminal
And we are not able to change it.
Effectively the Finance Minister
Is giving up his powers to chop and change
Tax rates in each annual Finance Bill.
The Code reduces options to add new taxes
Government will have to live within
Its extremely limited means.
Deficits have to be controlled.
Governments have to make bold choices.
India is today the largest buyer of Arms
The PM on child malnutrition sounds Alarms.
As Samuelson may have said
We have chosen Guns not Bread.

6
Industry will say it will spur growth
Private investment will see a boost
There will be Trickle Down
The Poverty Line will go to 41
This is good for everyone!

Dr. Vinod Vyasulu is a Bangalore-based economist with interests in a number of areas including fiscal decentralization, taxation and governance reforms. He has taught at various academic institutions including the Indian Institute of Management Bangalore, founded the Centre for Budget and Policy Studies (CBPS) in Bangalore and at present, advises CBPS, Centre for Budget and Governance Accountability and Indian Institute for Human Settlements, Bangalore.

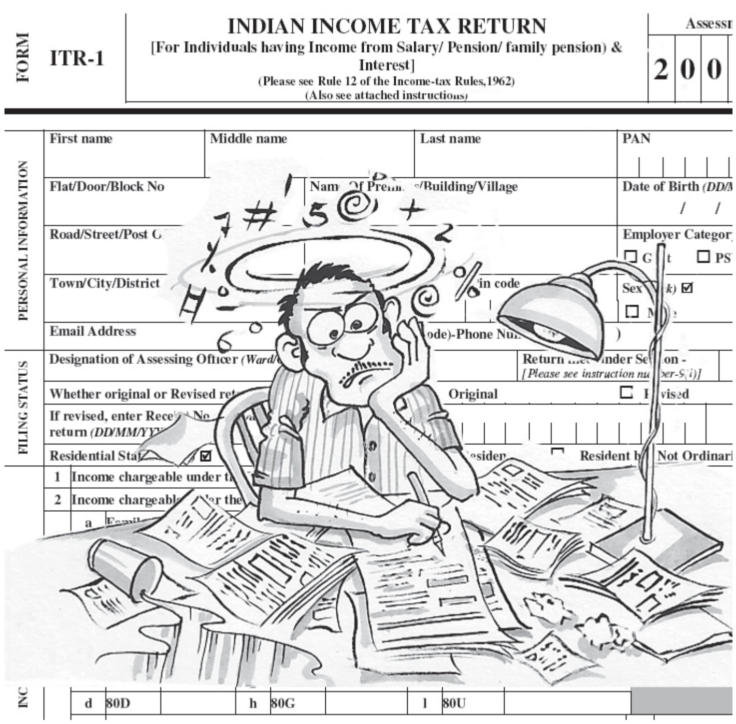
7
The Directive Principles in our Constitution
Repose responsibility on the Nation.
Union, States and local self governments
Together must provide basic services.
Our Government has responsibilities that
Go beyond embassies, defence and Police.
Primary Education is a basic right now
People need health care and social protection.
The DTC philosophy goes in a Different Direction.
What the private sector can profit from
It must clearly do. Where there is no profit
We need PPP–Partnerships for Private Profit.
It is this philosophy that is the Guiding
Principle of the proposed DTC.
Do we all agree?

8
The old IT Act may need replacing
But do we want this DTC?

9
It is not a bad idea to enact a DTC.
But we need one based on a different philosophy.
A DTC for a welfare State
Will provide for greater equity.
Broaden the tax base. Paying taxes
Is a citizen's responsibility.
A taxpayer citizen will care
For buses and public property.
The tax rate for the *aam aadmi*
Does not have to be a big percentage
It does not need much monitoring
Social pressure can encourage compliance.
We can at the top have a higher rate than 30 per cent
For the very rich of this country
There are people who earn a crore a month
If they pay 50 per cent they still have 50 lakhs.
We can tax unearned incomes like
Capital gains more equitably.
We can be capitalist in spirit
And bring in a death duty.
This will raise the money to implement
The obligations under the RTE.
It will help our States to build
A public health system for everybody.
We would welcome such a DTC.

10
Which will it be?
There are many social philosophies
There are alternate economic policies.
Let there be many draft DTCs
Freely debated in our society.
And the question of which DTC we
Enact will be up to the People.

This is a Democracy.
Thats It.



Tax Havens: Just Beyond Reach

Amitayu Sen Gupta*

In this era of globalised economies, the flow of capital across borders is perhaps the most talked about topic. It is commonly understood that capital from the developed countries flows into less developing countries to facilitate economic activities. The inflow of FDI in India is perhaps one of the biggest examples of this. However, if one were to go by official records, the biggest source of FDI inflow in India is not some big economy from the West, but the small island nation of Mauritius, which accounts for almost 40 per cent of all FDI coming to India! Compared to it, the USA accounts for only 6 per cent, Japan around 8 per cent, and the UAE for just 1 per cent. So does that mean that Mauritius is one of the richest economies in the world? The answer to this riddle is what has been plaguing all major economies in the world- tax havens.

DOUBLE TAXATION

As finance flows from one country to another, the question of the origin or owner of such capital becomes very important, as only the owner can be legally taxed for the incomes earned. In today's world, most investments are covered under double taxation avoidance treaties between countries, which ensure that any economic activity like investments should not be double taxed. Thus, any investor from Country A investing in Country B and thereby earning a profit cannot be taxed in both countries. A double taxation treaty between Countries A and B will chalk out proper guidelines that ensure both have some share of the taxes without putting additional burden on the investor. While such agreements are morally justified and are essential to ensure flow of capital across borders, there are loopholes that are being exploited by certain agents for malicious practices. One of the biggest issues here is the emergence of tax havens.

Tax havens are countries that have very lenient tax rules in order to encourage MNCs to register themselves in those countries. Additionally, these countries have laws and regulations that allow individuals or corporations to conceal financial information (either from domestic authorities or even international authorities or foreign countries), have a high degree of opacity in the legislative or administrative operations designed deliberately to prevent any such investigations, and actively encourage foreign entities to operate from their shores. Thus any company from Country A can register a subsidiary in a tax haven B, and channelise its investments through the subsidiary to Country C, in such a way that it avoids paying taxes in both Countries A and C, with tax rates in Country B being ridiculously low, perhaps even 0 per cent! Since all investments are made by the subsidiary company, neither Countries A nor C can claim taxes for the activity, as double taxation treaties between the countries A, B, and C prevent it.

The concept of tax havens is not new. In ancient Greece, traders would utilise other Greek islands as bases for importing items to avoid the taxes imposed on imported goods by the city-state of Athens. Swiss banks gained a reputation for parking funds post-World War I, not only because of their secrecy, but also because of the fact that Switzerland imposed very low tax rates on incomes compared to other European countries, which had to raise taxes to cover for the war expenses. However, with the increase of globalisation, and especially with the development of finance capital, the problem of tax havens has severely multiplied. The advent of information technology and digitalisation of the banking system has further accentuated the problem. It is very easy today to register a company in some tax haven, wire money transfer to a bank account in that country, and then transfer it to some investment destination. All it takes is a simple laptop, an Internet connection, and registered accounts. Subsidiaries registered in tax havens often do not have even an office, with just one employee operating out of some hotel room, transferring billions across the world.

CATCH THEM IF YOU CAN

While it is quite apparent why MNCs love tax havens, it needs to be understood why countries opt to be tax havens. In today's world of finance capital, all developing countries have to provide some kind of tax incentives to woo foreign investors. Tax holidays in Special Economic Zones (SEZs) are such examples which even India had to resort to. We have experts who are always suggesting that corporate taxes should be reduced or relaxed to ensure investments, economic growth, etc. The smaller a country, the more incentives it has to offer foreign entities to woo them. There is a very thin line between providing tax incentives, and ultimately, becoming a tax haven to be exploited by MNCs.

Island nations like Mauritius or Singapore have historically survived as being major ports for trading. Their geographical locations are perhaps the only resource they have to offer, wooing overseas traders to use their ports to transfer goods inland; they have historically offered lower port taxes to encourage the same. In an age when capital is the most traded commodity, it is not surprising that both these examples have emerged as major tax havens.

For small countries with very little natural resource or scope for industrialisation,

*Amitayu Sen Gupta has a PhD in Economics from Jawaharlal Nehru University and works at the Economic Research Foundation. The original version of this slightly-modified piece can be accessed at http://www.mediamates.biz/management_compass/punch_mark.html becoming a financial hub is the easiest and often only route to ensure existence. Despite very low tax rates, the income they earn out of it is greater than what their GDP would be otherwise. Often, countries become tax havens to encourage actual relocation of the production chain to their countries, which is essentially forming a SEZ to have MNCs set up productions base for exports. This provides some employment to the inhabitants, which compensates for the loss of tax revenues.

Instead of demonising such countries - as the media usually does - it needs to be understood that the global economy dictated by finance capital itself has actively encouraged the emergence of tax havens to serve its interests. As MNCs become larger entities than nations themselves, some nations will always succumb to being tax havens while others will have to face the consequences of losing out on revenue.

It is not just small nations that run the risk of becoming tax havens. India itself runs the risk of becoming one, as the finance minister recently said in the context of the State of India versus Vodafone battle over taxation. Sovereign rights to determine one's tax structure is being severely undermined by the plethora of international treaties and investment incentives, with the threat of FDI outflow looming if the country does not act according to the diktats of the MNCs. In the meantime, we are struggling to review India's treaties with Mauritius (which is one of the nine tax havens officially recognised by the Indian State) and make amends in our own tax laws to recover the loss of tax revenues to tax havens like Mauritius and Singapore - which are the top two sources of all FDI being channelised to our economy. Thus, the issue of tax havens is a double-edged sword in today's world of finance capital, and both developing and developed nations are trying desperately to find a solution to the problem.

Rationale for Ending Secrecy of Tax Havens and How It Could Be Done

Matti Kohonen*

According to the most recent estimates, between USD 11.6 billion (Rs.646.10 billion**) and USD 14.3 billion (Rs.796.48 billion) of capital flows illicitly out of India every year due to organised crime, kickbacks, embezzlement and unlawful commercial transactions arising from false invoicing and tax evasion.[1] In comparison, the official figures for merchandise and services trade in India in 2010 was USD 776 billion[2] (Rs.43222.03 billion), meaning that approximately 2 per cent of trade in the region could be subject to illicit flows defined as a transaction which breaks the law in its origin, transfer or use of funds[3].

The Tax Justice Network (TJN) has estimated that about USD 11.5 trillion (Rs.640.53 trillion) of funds is held in tax havens, while more conservative estimates put the figure at USD 7.8 trillion (Rs.434.44 trillion).[4] Of this smaller figure, USD 1.8trillion / Rs.100.25 trillion (23 per cent) is estimated to be of Asia-Pacific origin, as the figures is not broken down on a country-by-country basis in these statistics presented to the public. The total wealth in the Asia-Pacific region was estimated at USD 21.7 trillion (Rs. 1208.65 trillion) in 2010, of which the offshore wealth was USD 1.8 trillion (Rs. 100.25 trillion)or 12.1 per cent of total wealth. The estimated distribution of these assets is given in Table 1[5]:

Table 1: Asia-Pacific Offshore Wealth

Country	Assets under Management In Million USD (Figures in Million Rupees*)
Switzerland	250 (13925)
UK, Channel Islands, Dublin	360 (20051)
Luxembourg	60 (3342)
Caribbean, Panama	150 (8355)
Hong Kong, Singapore	700 (38989)
United States	170 (9469)
Other (inc. Dubai and Monaco)	120 (6684)
Total	**1,800 (100257)**

*Figures rounded-off to nearest whole number.

This is also a reasonable estimate for India and could be used as a basis for estimating subsequent tax losses according to the method developed by TJN to estimate global tax losses[6]. Despite the common perception that the majority of India's tax haven assets would not be in Switzerland, it seems that more funds are located in Hong Kong and Singapore and a sizeable amount are in the Channel Islands and Dublin. Also, the position of the United Kingdom is crucial in the global offshore market[7]:

"UK offshore banks, especially those based in London, are considered very strong in complex structures such as multijurisdictional trusts, as well as in asset management and mutual funds – and are well positioned to attract offshore wealth from China, India [...]"

Indeed many of the tax havens around the world are either UK Crown Dependencies such as the Channels Islands and the Isle of Man, or Overseas Territories including many Caribbean and Pacific Rim islands.

Tax havens are at the centre of the erosion of tax revenues in India, but there is no single definition among governments, researchers and policy-makers to define such a country or territory. The most common is the one used by the Organisation of Economic Co-operation and Development (OECD), which defines a tax haven as a territory that (i) lacks transparency; (ii) with an absence of laws or administrative practices to prevent effective exchange of information for tax purposes; (iii) with an absence of requirements for substantial activity[8]. Based on such criteria, OECD in 2009, after being requested by the G20, decided that the minimum of 12 tax information exchange treaties according to the new OECD model tax convention was a sufficient condition for compliance.

The IMF in a working paper[9] has a slightly different definition for an "offshore financial centre" (OFC) as a territory that provides financial services to non-residents. The key indicator to look at OFCs is the size of the financial centre activity with regard to the domestic economy. Meanwhile, the Financial Action Task Force (FATF) has used exclusively the term "non-cooperative jurisdictions". Their 2012 list[10] included countries with perceived inadequacies in adopting tough anti-money laundering and anti-terrorism laws such as Iran, Bangladesh and Myanmar. Their list is insignificant and picks up on weak nations or states which are far from the centre of the problem.

* Matti Kohonen is a sociologist and founding member of the Tax Justice Network (TJN), headquartered in London. He is currently working on building a global tax justice campaign for TJN. He has authored several publications including Tax Justice: Putting Global Inequality on the Agenda (Ed.).

**Exchange Rate 1USD = Rs.55.6985 as on 12 July 2012.

The term “preferential tax regime” has been used by the Brazilian Federal Tax Administration to describe practices that are deviant from Brazilian practices, and gave rise to an OECD report in 1998 that used the term “harmful tax competition”. The Brazilian list[11] includes common “treaty shopping” havens such as Holland, the US State of Delaware and also Denmark with its holding company laws, and separately low-tax jurisdictions. Other countries in Latin America, including Argentina and Ecuador, have used similar criteria. The US General Accountability Office (GAO) has also used a mix of criteria[12] from the IMF and a definition of low-tax regimes.

The third set of definitions relate to political economy of tax havens in a global economy. Here, one of the founding studies is by Doggart[13], which considers that it is the creation of rules that undermine rules of other territories. The TJN’s Financial Secrecy Index (FSI) also adopts a political economy definition, and uses the term “secrecy jurisdiction” defined by Murphy[14]:

“Firstly, secrecy jurisdictions create regulation that they know is primarily of benefit and use to those not resident in their geographical domain. Second, secrecy jurisdictions create a deliberate, and legally backed, veil of secrecy that ensures that those from outside that jurisdiction making use of its regulation cannot be identified to be doing so.”
The Financial Secrecy Index 2011 maps 73 jurisdictions according to 15 Key Financial Secrecy Indicators (KFSI). For instance, Mauritius has a financial secrecy score of 74 per cent[14], which together with a global weighing of the importance of the centre gives Mauritius 33rd position on the Index. The cut-off index rating when a jurisdiction should be considered a secrecy jurisdiction is dependent on the context when secrecy is defined, and no single line can be defined within a wider “secrecy spectrum”. Possibly, not a single of the approximately 250 jurisdictions that have tax or legal sovereignty would currently score a zero per cent.

The key proposals to end financial secrecy have been outlined by the Task Force on Financial Integrity and Economic Development. It considers that tackling the following five issues is crucial: (i) trade mispricing, (ii) country-by-country reporting (CbC); (iii) beneficial ownership; (iv) automatic tax information exchange; and (v) money laundering. This agenda is quite clear, but does not set out an action plan to get rid of tax havens or secrecy jurisdictions in their current form. And thus, every country and region would need to work out how they can achieve financial transparency within the different contexts and join up their efforts. This work is yet to really begin, as focus has been on large international institutions such as the OECD and the UN.

Looking at the dilemma between India and Mauritius, it would seem that the first thing to do would be for India to establish a list of effective criteria upon which it would penalise financial movements inwards and outwards to secrecy jurisdictions as Brazil and the US have done. Outlining Mauritius as a “preferential tax regime” and placing a punitive fine would set in motion a wider political process. Such criteria should be clear and objective. Then there would be grounds to consider Mauritius more effectively of violating the spirit of the earlier Double Taxation Treaty (DTT) - which could be suspended until Mauritius adopts full disclosure of beneficial ownership of all legal vehicles, including trusts and charitable foundations, and is willing to co-operate in both tax and judicial information exchange on an automatic basis.

Progress on CbC and trade mispricing go hand-in-hand, as it is through the effective application of more transparency in corporate accountability that we can even envisage that the current system of international taxation based on transfer pricing and the “arm’s length principle”

[1]Kar, D and Curcio, K. 2011 *Illicit Financial Flows from Developing Countries: 2000-2009: Update with a Focus on Asia. Figures are averages for the years 2000-2008*
[2]World Trade Organisation 2011 *Trade growth to ease in 2011 but despite 2010 record surge, crisis hangover persists* (http://www.wto.org/english/news_e/pres11_e/pr628_e.htm#atable1) adding up both World exports and imports of merchandise goods (Appendix tabla 1), and services (Appendix Table 2). This is the potential base in which trade mispricing can occur.
[3]This definition is adopted from Kar, D. And Cartwright-Smith, D. 2008 *Illicit Financial Flows form Developing Countries 2002-2006*, Global Financial Integrity: p. iv.
[4]Boston Consulting Group 2011 *Global Wealth 2011: Shaping a New Tomorrow*
[5]Ibid. p. 13
[6]TJN 2005 Op. Cit.
[7]Boston Consulting Group 2011 Op. Cit.
[8]OECD 2012 Tax Haven Criteria. (http://www.oecd.org/document/63/0,3343,en_2649_37427_30575447_1_1_1_37427,00.html)
[9]Zoromé, A. 2001 *Concept of Offshore Financial Centre: In Search of an Operational Definition*. (http://www.imf.org/external/pubs/ft/wp/2007/wp0787.pdf)
[10]Previous lists were drafted in 2000, 2001, 2007 in Annual Reviews of Non-Cooperative Countries and Territories.
[11]Receita Federal 2010 *Instrução Normativa RFB nº 1.037, de 4 de junho de 2010*. (http://www.receita.fazenda.gov.br/Legislacao/Ins/2010/in10372010.htm)
[12] US GAO 2008 *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*(http://www.gao.gov/products/GAO-09-157)
[13]Doggart, C 1975 *Tax Havens and Their Uses*. London: Economist Intelligence Unit.
[14]Murphy, R. 2011 *Defining the Secrecy World: Rethinking the language of 'Offshore'*(http://www.secrecyjurisdictions.com/PDF/SecrecyWorld.pdf)
[15]Mapping Financial Secrecy 2011 *Report on Mauritius*. (http://www.secrecyjurisdictions.com/PDF/Mauritius.pdf)
[16]For more information about these proposals, see TJN’s transfer pricing page (http://www.taxjustice.net/cms/front_content.php?idcat=139)
[17]Bhagwati, J.N. 1964 'on the underinvoicing of imports' in *Bulletin of the Oxford University Institute of Statistics*, November; Singh, Kavaljit 1997 'The reality of foreign investments: German investments in India 1991-1996. Delhi: Madhyam Books.

can function. If even with CbC the system does not work to curb excessive corporate tax dodging, then campaigners might need to focus on alternative ways of allocating the corporate tax base between countries, using the formulary apportionment method, also known as unitary accounting[16]. But I do not foresee this in the near future. Rather, first steps need to be taken at the regional level, and then moving to implement inter-regional treaties, and ultimately a global treaty much like the WTO took decades to negotiate.

The problems of tax havens, transfer pricing abuses and illicit financial flows have been around since financial markets were deregulated during the 1970s[17], but the urgency on the issue is growing owing to the phenomenal growth of private wealth and corporate profit shifting taking place in secrecy jurisdictions. Tax co-operation is no different from the co-operation in trade, customs and other issues where international political will has already been mobilised. The difference is that tax dodging hurts the poor and their voice is listened to much less than the voice of big businesses and ultra-rich in making international treaties and new rules. Advancing quickly on beneficial ownership and automatic tax information exchange would yield more results than all anti-terrorism laws combined across the world. Taking a holistic view of seeing corruption, money laundering, terrorist financing and tax dodging, all linked to one another through the use of secrecy jurisdictions, gives campaigners a common cause, a platform and an ask to put to their elected representatives. The time indeed has come to end tax haven secrecy.

Raising Innovative Funding for Development: An Alternate View

Ram Kishan*

A large funding gap looms on the horizon as the 2015 deadline for alleviating poverty and other internationally agreed-upon Millennium Development Goals (MDGs) draws closer. The United Nations' Monterrey Conference on Finance for Development in 2002 sought to increase Official Development Assistance (ODA) from 0.23 per cent of donors' gross national income (GNI) in 2002 to 0.7 per cent of GNI. But ODA, excluding debt relief, was only 0.25 per cent in 2007. Current commitments from donors imply that ODA will increase to only 0.35 per cent of their GNI, half the target level, by 2010 (World Bank 2008). There is little doubt that developing countries need additional, cross-border capital channelled to the private sector. Needless to say, developing countries must be prudent and cautious in resorting to market-based sources of finance. Such borrowings must be within the limits of each country's absorptive capacity. Rather, it is to use the backdrop of these events to focus on the innovations that occurred in the provision of finance for development.

The interest in innovative financing for development is based on two observations:

- Traditional Official Development Assistance, albeit some USD 120 billion (Rs.6683.82 billion[1]) a year, will not be enough to reduce extreme poverty, as defined in the Millennium Development Goals for 2015 (MDGs), and to mitigate and adapt to climate change;
- The market and private investment are attracted to profitable countries and sectors, and cannot, therefore, meet the needs of the most vulnerable countries.

The term "innovative financing" refers to various types of mechanisms for raising further resources for development. The best known are the Financial Transaction Tax (FTT), air-ticket solidarity levy that finances UNITAID and the International Finance.

These types of financing are innovative in a number of ways:

- They are based on activities that have benefited from globalisation: transport, trade, finance;
- They are a stable, predictable, sustainable resource coordinated between governments, which is precious for financing long-term needs
- They have a new form of governance combining states at various levels of development and private stakeholders

Innovative financing is a modern way for governments to act, by directly raising funds and also encouraging and channelling private voluntary contributions. Innovative financing for development represents a considerable potential.

The problem

The Indian economy was growing at well over 8 per cent. In spite or because of this, it does not produce enough of what it needs. So, it needs to import a lot of things. But it does not export enough to pay fully for these imports. The gap in what it owes to foreigners is called the current account deficit. It is made up by large inflows of foreign money. Most of it comes into the capital market. Small amounts of direct foreign investment in building factories also help. While Foreign Direct Investment (FDI) is here to stay, the capital market inflows come and go at will. This coming and going is called volatility. Volatility causes serious problems for the management of the economy because of its unpredictable nature. To tackle this, governments impose what are called Financial Transactions Tax (FTT).

The potential of a FTT

An FTT, depending on the number of implementing countries and the desired rate chosen, could raise up to USD 650 billion (Rs.36204.02 billion) per year if implemented globally. This would permanently change the development landscape by quintupling the current level of ODA. However, innovative sources of financing should complement ODA commitments and not replace them. Prior donor commitments – especially towards multi-country initiatives (the G8's 2010 Muskoka Initiative, for example) or multilateral mechanisms (the GFATM-Global Fund to Fight AIDS, Tuberculosis and Malaria, and GAVI10, among others) – remain critical for theintended life-saving purposes.

General comments on FTT

- Among the many innovative sources of financing for development, FTTs have proven to be easily administered, offer the greatest potential to maximize resource delivery, and have garnered significant political momentum and public attention.

*Ram Kishan is associated with the Wada Na Todo Abhiyan and at present works with Christian Aid. He has been actively involved at the national and international levels on the discourse towards promoting government financing for critical entitlements and has been advocating for increased public financing for development.

[1] Exchange Rate 1USD = Rs.55.6985 as on 12 July 2012

- A tax of 0.05 per cent has the potential to raise five times the current level of ODA.

- There are several precedents for such a tax and countries that are unwilling to implement the FTT at the same time are unlikely to oppose a coalition of the willing.

- FTT revenue for development should be channelled to countries through international institutions, such as Global Fund to fight AIDS, Tuberculosis and Malaria (GFATM), UNITAID[2], United Nations Population Fund (UNFPA), International Health Partnership (IHP+).

- 50 per cent of FTT raised revenues can be spent on domestic needs, 50 per cent should be spent on development, particularly health helping to reach MDGs.

- The FTT is a progressive tax: While empirical evidence is inconclusive on this issue, most point out that in the short run, the incidence of the tax would be felt the most by those engaging in high frequency trading. Such activity is often linked to excessive leverage – and consequently to instability in the financial markets. In the long run, given wealth distribution in society, an average household's income would not be substantially impacted by what some predict to be reduced earnings from capital investment caused by an FTT. In this sense, an FTT is more progressive than other forms of taxation such as a Value Added Tax (VAT).

- Efficiency gains for an FTT will be significantly multiplied the more broad its scope and the more general its implementation

- Financial instability is the enemy of economic development. Policy-makers looking for innovative ways to finance development are therefore, charged with two equally important tasks: stabilising the financial system and stimulating development. FTT, a variation of a Tobin tax, is the ideal policy instrument to address both by shifting capital flows from short-term speculation, which destabilises markets, to longer-term investment, which, on the margin, can encourage real investment in development if coupled with other supportive policies. The significant revenue stream that would be generated from a global FTT could be, in part, directed to sustainable development, augmenting the flow of capital geared towards stimulating development. FTT would do three critical things: combat financial short-termism, improve market resiliency, and generate needed revenue. Furthermore, the principle argument against FTT, regarding how it affects liquidity, is irrelevant in a crisis and would have a limited effect on the real economy in non-crisis times.

Actions required:

- The G8 and the G20 (mainly developed countries) should agree to the introduction of a FTT.

- If it does not prove possible to secure global agreement to the FTT within the next year, the Eurozone countries and the UK should introduce the tax within their own jurisdictions.

- At least half of the resources raised through a FTT should be used for global public goods, including support for development and poverty reduction in the poorest countries and climate change mitigation and adaptation.

- A proportion of the resources raised should also be used for anti-poverty programmes in developed countries such as the UK.

- Resources should be allocated through existing mechanisms, rather than through new structures created to disburse the funds.

- Donors should reaffirm that resources generated by the FTT are additional to their existing aid pledges and commitments, which should be honoured in full.

Nevertheless, many examples of actual use of FTT exist across the world though, often, they tend to be temporary once their specific, momentary objectives are met. Hence they seem to be disliked even by the policy-makers that use them obviously for their well-recognised deleterious efficiency ramifications.

The design of a comprehensive, efficient, equitable and revenue productive FTT remains complex since it is difficult to define an appropriate base that would meet all criteria. Issues that challenge include, first, how to distinguish between short-term and long-term elements so that only the former may be targeted by tax. Country experiences reveal the essential arbitrariness of this distinction. Second, distinguishing debt and equity is not obvious since their separation is not seamless. Third, the treatment of derivatives remains a stumbling block: whether to tax the underlying value at a very low rate, or whether, and how, to tax "Call and Put" option instead. Fourth, the treatment of financial intermediaries remains crucial if we are to remain cognizant of not taxing a particular financial asset more than once. Therefore, it is not easy to be optimistic about a well-designed FTT that successfully addresses issues of efficiency and equity. Nevertheless, in a turbulent global financial environment, it is to be expected that a FTT would be used unilaterally by a country to protect itself from unwanted capital inflows, or that multilateral attempts would be made by those countries nearest to financial turbulence. However, under extreme circumstances,

[1] UNITAID is an international drug purchase facility focusing on increasing access to drugs for AIDS, Tuberculosis and Malaria

history reveals that non-tax structural institutions, rather than a tax, are needed to seek and support the trajectory out of deep recession.

In conclusion, between the two, the non-tax regulatory route has greater advantages than does FTT. If both instruments are to be used, a very small, temporary, global FTT with clearly earmarked equity goals may be envisaged. For that, consensus and trust building is needed among big economies for a surge towards unsustainable deficit and debt to which rating agencies are reacting adversely ever so strongly.

How Low is India's Tax GDP Ratio?

Neha Hui*

Taxation plays an intricate and pivotal role in the growth and advancement of any nation, with the objectives of its taxation policy being corollary to its general economic and social policy. Being a major and vital source of revenue, a sound taxation system is imperative for the public finances of a country and for improving citizen participation (Cobham 2007; Fjeldstad 2008) whether that is in any stage of the progressive process - developing, developed or transitional. Hence, it is extremely important to demystify the revenue side of the budget, in particular, the policies and practices pertaining to taxes.

The fiscal space for the government in a country like India depends significantly on the overall magnitude of tax revenue, it being a sustainable source of government funding. Among the other major sources of revenue for the Government in India, non-tax revenue, disinvestment proceeds and borrowing constitute major components. However, the last two sources of funds are one-off payments and are not sustainable in the long run. Too much dependence on any of these three sources of funds could imply a number of serious concerns. Hence, tax revenue plays a very important role for the overall fiscal policy space available to the government.

The extent of government expenditure financed by taxes is comparatively low in India as compared to the developed countries of Canada, UK, USA and Japan. While this share (of government expenditure financed by tax revenues) goes up to 90 per cent in case of South Korea, it has been close to 80 per cent in Canada, UK, USA and Japan. However, in India, this share has been less than 70 per cent. Thus, we need to question the policy priorities in India pertaining to resource mobilization.

India's Tax GDP Ratio

India's low level of tax-GDP ratio has long been a cause of concern. Particularly after liberalisation, there was a slump in the gross central taxes due to reduction in the rates of customs duties[1] and excise[2]. But the net result was that the tax-GDP ratio for India registered a sharp decline during the 1990s and in the early years of the present decade. The magnitude of Total Tax Revenue in India fell sharply from 16 per cent of the GDP in 1989-90 to 13.8 per cent of the GDP in 2001-02, before it started recovering gradually from 2002-03. During this period, while the magnitude of the states' Own Tax Revenue increased marginally from 5.36 per cent of the GDP in 1989-90 to 5.59 per cent of the GDP in 2001-02, the magnitude of Central Taxes fell noticeably from 10.62 per cent of the GDP in 1989-90 to 8.21 per cent of the GDP in 2001-02. The recent economic crisis (of 2008 and 2009) again had a disparaging impact on the country's tax-GDP ratio, specifically on the central taxes, while the state tax-GDP ratio remained more or less unaffected.

Comparison of Tax-GDP Ratio with Developed and Developing Countries

From the graph, it is evident that India's tax revenue is far below the levels of tax revenue collected in developed countries with Sweden and Denmark's collection being almost 50 per cent of GDP.

Additionally, it is to be noted that the developing countries depend more on direct taxes for revenue generation than indirect taxes. Whereas in USA, UK, Canada and Japan, revenue ensuing from direct taxes comprises of 60 per cent, 52.1 per cent, 58.3 per cent and 45.2 per cent respectively; for India, it is only 34.1 per cent. This reflects the extent of regressive nature of India's tax structure. But since liberalization, India's dependence towards direct taxes is steadily increasing in comparison to indirect taxes.

A comparison with other developing countries further highlights the low tax revenue in India, with South Africa, Russia and Brazil having much higher tax revenues.

Progressivity of India's Tax Structure

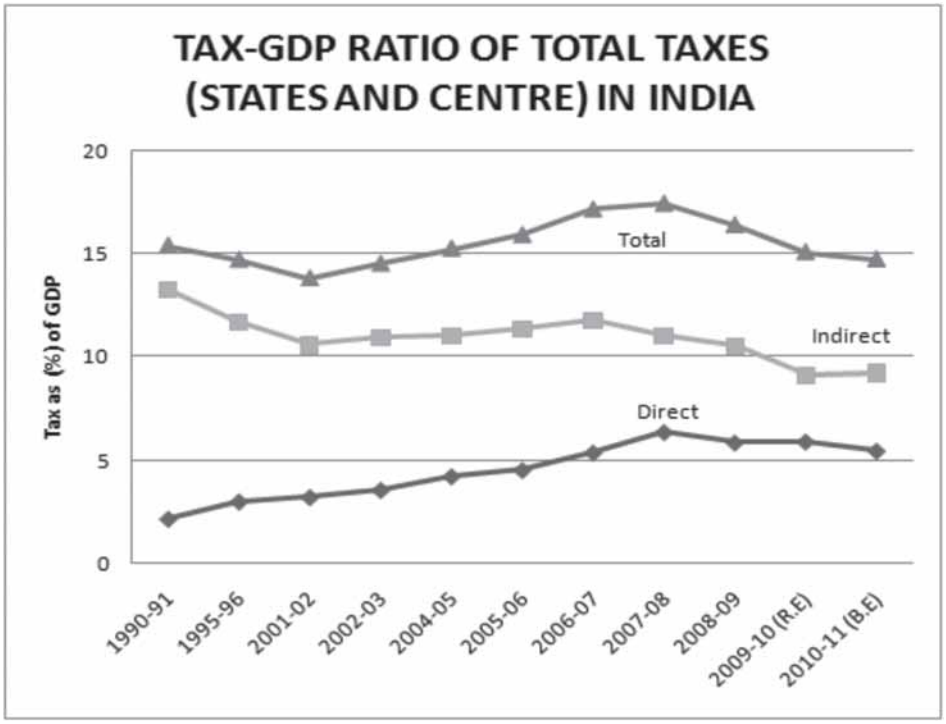
Of the total tax revenue of our country at 14.73 per cent of GDP (in 2010-11), while indirect taxes account for 9.25 per cent of GDP, direct taxes account for only 5.48 per cent of GDP[3]. India's tax system, which collects almost two-third of the revenue from indirect taxes and only one-third from direct taxes, is regressive as compared to the tax system of many other countries that collect a much higher proportion of tax revenue from direct taxes. If India is to move towards a more progressive tax system, the government should rely more on direct taxessuch as, corporation tax, personal income tax and wealth tax.

*Neha Hui was till recently working with the Centre for Budget and Governance Accountability (CBGA) as a Research Consultant focusing on tax-related issues. She is a recipient of the Commonwealth Scholarship and is planning to pursue her doctoral studies in the UK.

[1]Customs duty is an indirect tax which is levied on goods of international trade. It is a kind of consumption tax. It is of two types: Import duties are levied on imports and export duties are levied on export of goods

[2] An excise is an inland tax on the production and sale of a specific good within the territory of the country.

[3] Indian Public Finance Statistics, 2010-11, Govt. of India



Source: Indian Public Finance Statistics, 2009-10, Govt. of India

a major stepping up of public provisioning for inclusive development; but that would require the government to adopt progressive policies in the domain of taxation. The overall magnitude of public resources available to the government in India for making investments towards socio-economic development remains inadequate in comparison to several other countries, mainly owing to the low magnitude of tax revenue collected in our country. The total tax revenue collected by Centre and States (combined) has fallen from the already low level of 17.4 per cent of GDP in 2007-08 to 14.7 per cent of GDP in 2010-11 (BE). Hence, it is critical to emphasize the need for and the feasibility of increasing the country's tax-GDP ratio. The gross tax revenue collected under the Central Government tax system is projected to increase rather slowly from 10.1 per cent of GDP in 2011-12 (RE) to 10.6 per cent of the GDP in 2012-13 (BE) and at a similar rate over the next two years.

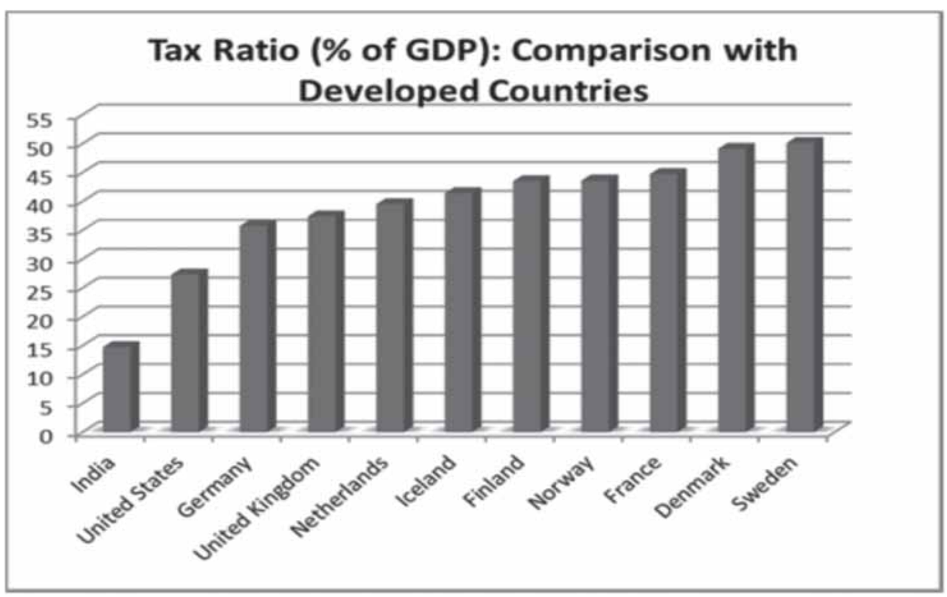
The Finance Minister has referred to some efforts towards plugging the loopholes pertaining to tax avoidance in offshore transactions, which is welcome. However, the Union Budget for 2012-13 should have also focused on reducing significantly the amount of tax revenue forgone due to

Tax Proposal in Union Budget 2012

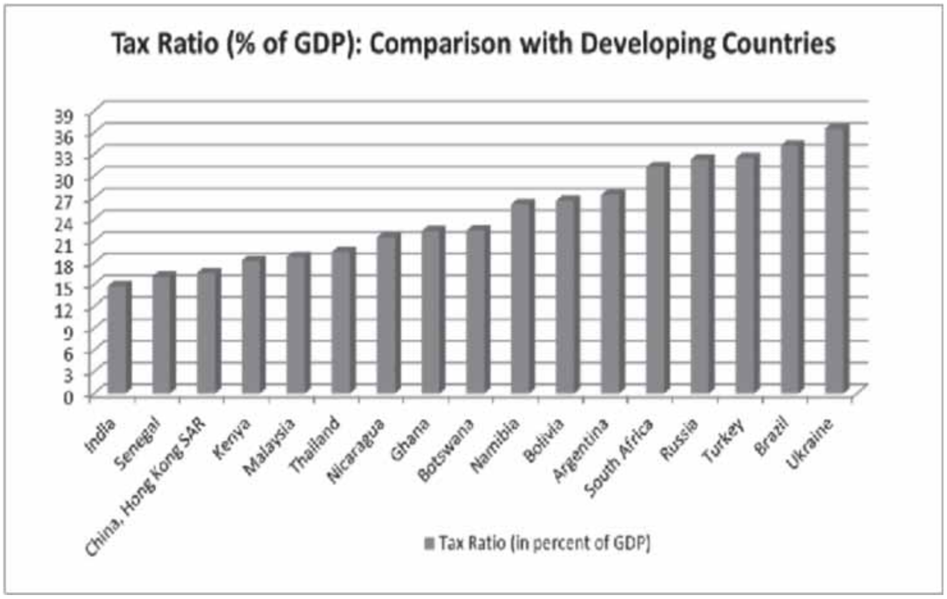
It is evident that the progressivity of the tax structure in India is far below the international levels. Also, the country needs to significantly increase its tax-GDP ratio for adequate resource mobilization. In terms of the tax rates in personal income and corporate tax, we found that India already has moderate rates and graduated slabs. Thus, at present there may be no strong rationale for reducing the tax rates further.

The UPA-II government has sent clear signals to the captains of industry and finance that it would strive to reduce borrowing but not put them off with any thrust for raising higher amounts of tax revenue in the coming years. The targets for reduction of fiscal deficit in 2013-14 and 2014-15, as stated in the latest budget, indicate the government's intent of reducing borrowing significantly over the next few years. However, if the government does not step up its tax-GDP ratio, such a reduction of borrowing can happen only by checking the growth of government expenditure as compared to the growth of the economy. The magnitude of the Union Budget is projected to decline marginally from 14.8 per cent of GDP in 2011-12 (RE) to 14.7 per cent of GDP in 2012-13 (BE).

The acute human development deficits confronting India in several sectors require



Source: IMF, Revenue Mobilization in Developing Countries, 2011 and Indian Public Finance Statistics, 2010-11, Govt. of India



Source: IMF, Revenue Mobilization in Developing Countries, 2011 and Indian Public Finance Statistics, 2010-11, Govt. of India

a plethora of exemptions in the Central Government tax system and improving the collection of tax revenue in detected cases of tax evasion (i.e. the pending arrears of tax revenue raised but not realized).

Moreover, in a society deeply affected by inequality, such as ours, taxation is also linked intrinsically to the issue of social justice. India's tax system, which collects almost two-thirds of the revenue from indirect taxes and only one-third from direct taxes, is regressive as compared to the tax system of many other countries (that collect a much higher proportion of tax revenue from direct taxes). Hence, the policies of the Union Government relating to taxation need to strive for more progressivity in our tax system by collecting a higher proportion of revenue from direct taxes. However, the proposals made in Union Budget 2012-13 would aggravate the regressivity of the tax system in the country; it is recognized in the budget that a net revenue loss of Rs.4500 crore would occur as a result of proposals relating to direct taxes, while a net revenue gain of Rs.45940 crore is estimated from proposals relating to indirect taxes.

To Conclude...

The total magnitude of tax revenue forgone due to exemptions/ deductions/ incentives in the Central government tax system was estimated (by the Ministry of Finance itself) to be Rs. 5.02 lakh crore in 2009-10. Its implications are overwhelming; a liberal estimate of the amount of additional tax revenue which could have been collected by the Central government in 2009-10 – if all exemptions/ deductions/ incentives (both in direct and indirect taxes) had been eliminated –stands at a staggering 8.1 per cent of the gross domestic ratio (GDP). The bottom line is that if India is to move towards a more favourable tax-GDP ratio, the government should rely more on direct taxes rather than indirect taxes that are regressive.

Tax Exemptions in India

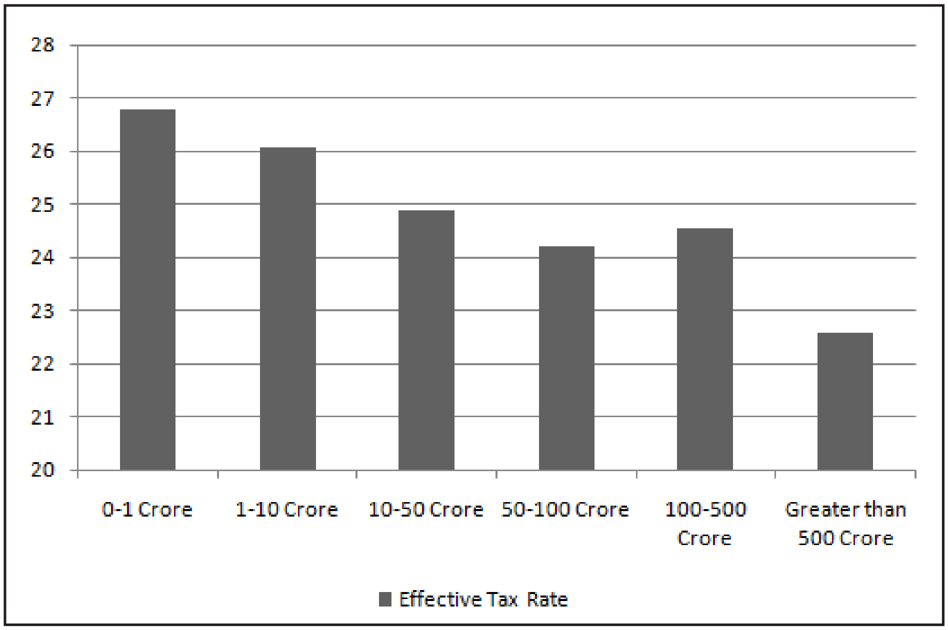
Sankhanath Bandyopadhyay*

The main objective of any tax system is to raise revenues to fund government expenditures. The amount of revenue raised is determined to a large extent by tax bases and tax rates. Ideally, tax rates should not be too high and tax base too narrow. A range of measures such as special tax rates, exemptions, deductions, rebates, deferrals and credits also affect the level and distribution of tax. These are known as tax preferences, which may be viewed as subsidy payments to preferred taxpayers and such implicit payments are referred to as tax expenditures.[1]

Since 2006, the Union government has been publishing a *Statement of Revenue Foregone* as part of the Union Budget documents in order to provide more transparency in the tax policy. This document lists the tax exemptions and concessions given to individuals / corporates and calculates the revenue lost or foregone by the Central government as a result of such exemptions.Tax expenditures are incurred (or tax incentives are provided) for a number of reasons, some of which are as follows:

- To encourage individual savings (this is done by providing tax relief to various savings schemes)
- To provide a boost to the export sector
- To achieve balanced regional development (by providing tax exemptions to backward sector)
- To encourage infrastructure development
- To increase employment by providing tax incentives to employers
- To provide more resources to charity, cooperatives and for rural development

Figure 1: Effective Tax Rate: Small vs. Large Companies in India



Source: Compiled from "Statement of Revenue Forgone" Ministry of Finance, GoI, 2011-12.

Note: (1) This graph shows different Effective Tax Rates (ETRs)[in per cent] paid by different companies of Corporate Sector(chosen as a group of sample companies from the entire corporate sector) for the financial year 2010-11.The horizontal axis shows range of different profit levels(profit before taxes) of companies. The vertical axis shows Effective Tax Rates(in per cent). It can be observed that lower level of profit making companies pay greater ETR compared to higher profit making companies. For instance, companies making profits in the range of 0-1 crore , pay ETR 26.77%, whereas companies making profits in the range of Greater than 500 crore pay ETR of 22.59%.

Tax expenditures are usually calculated for corporate and non-corporate taxpayers. The category provided by the Department of Revenue, Ministry of Finance, is broadly as follows:

Direct Taxes:

- Corporate Sector
- Non-Corporate Sector[2]
- Individual Taxpayers

Indirect Taxes:

- Excise Duties
- Custom Duties

As per the Statement of Revenue Foregone figures published by Government of India as part of the Budget documents, in some sectors the amount of revenue foregone are substantial and should be reviewed. Though some exemptions in customs in certain sectors (railways, infrastructure) can be accepted, however, *how effectively* such exemptions are provided and *what anticipated benefits are actually accruing* from such exemptions needs to be carefully scrutinized.

As per Annex 15 of Receipts Budget in the Union Budget 2012-13 (Statement of

*Sankhanath Bandyopadhyay works with the Centre for Budget and Governance Accountability (CBGA) as Research Officer and researches on tax-related issues. His areas of focus include reforms in direct and indirect taxes, issues pertaining to tax evasion, tax avoidance and tax exemptions.

[1] The term "Tax Expenditure" is used to denote the cost of tax incentives/preferences/exemptions in terms of lost potential tax revenue of the government (i.e., the estimated revenue the government would generate if the tax incentives were not provided).

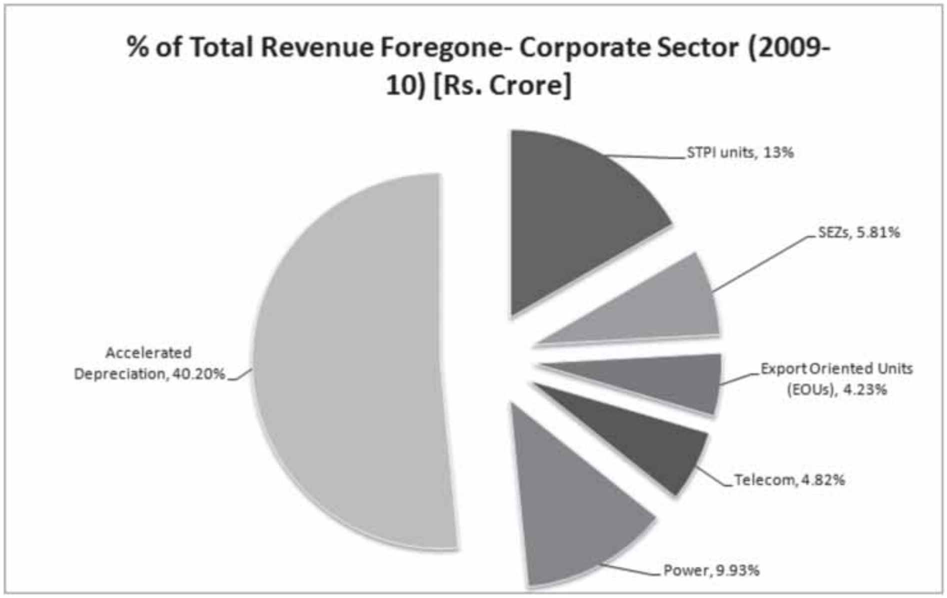
[2] Apart from Corporate sector, partnership firms, Association of Persons (AOP) and Body of Individuals (BOI) are also engaged in large business enjoying tax exemptions and deductions. See, "Revenue Forgone under the Central Tax System: Financial Years 2009-10 and 2010-11", Ministry of Finance, URL: http://indiabudget.nic.in/ub2011-12/statrevfor/annex12.pdf; p.23-25.

Revenue Foregone under Central Tax System: Financial Years 2010-11 and 2011-12), companies with the largest share in total profits paid an effective tax rate below 20 per cent while companies with the lowest share in total profits paid the highest effective tax rate of 33.21 per cent or higher. Again, from Economic Survey data, (Receipts Budget of years 2007 - 2010) it has been found that companies with higher level of profits (accounting for most of the aggregate corporate profits in the country) end up paying much lesser tax (much lower effective tax rates) than companies with lower amount of profits, which pay relatively more tax (higher effective rates). It reflects that major concessions and preferences favour bigger corporations rather than smaller ones.(Figure 1)

On an average, the statutory tax rate for corporations is 33 per cent but the Effective Tax Rate paid by them is only around 24 per cent. Revenue foregone in the Central Government tax system on account of deduction of export profits for STPI Units (software technology promotion industries), Export-oriented Units (EOUs) and accelerated depreciation are substantial; in particular, the depreciation allowance/accelerated depreciation[3] is a dominant factor underlying the tax revenue foregone (Figure 2).

With regard to tax exemptions, the 49th Report of the Parliamentary Standing Committee on Finance has emphasised that each exemption should serve an economic purpose; and added that an annual or periodical review of each of the exemptions is also crucial in assessing the fulfillment of their economic purposes. It has also opined that exemptions should not be for a very long period. The Union Finance Minister had recognized in the 2009-10 Budget Speech that India's tax

Figure 2: Total Revenue Foregone by the Corporate Sector in 2009-10 (in per cent)



Source: Compiled from "Statement of Revenue Forgone" Ministry of Finance, GoI, various years

base continues to be low compared to other countries, mainly due to a plethora of exemptions/ deductions/ incentives in the Central Government tax system.

Across various sectors and activities, deductions for Software Technology Parks (STPs), Special Economic Zones (SEZs), Diamond and Gold (precious stones & jewellery), Mineral Fuels and Mineral Oils and the power sector and weighted deduction for expenditure on scientific research account for the major component of the total tax forgone.

According to the Statement of Revenue Foregone, Union Budget 2012-13, "revenue forgone on export profits of units located in SEZs for financial year 2010-11 was projected at Rs.5126 core in the previous year's statement. However, based on the data available, the actual revenue forgone during 2010-11 on these units is now estimated at Rs. 7432 crore. For financial year 2011-12, revenue forgone on account of these units has been estimated at Rs.8153 crore. Keeping in mind the increase in revenue forgone in financial year 2010-11, the actual revenue forgone in financial year 2011-12 in respect of units located in SEZs may be higher than the estimate."[4]

As regards the revenue foregone, the following account for major components:

- Special Economic Zones (deduction of export profits of units located in SEZs),
- Depreciation allowance / accelerated depreciation,
- Diamond and Gold (precious stones and jewellery),
- Mineral Fuels and Mineral Oils,
- Power sector

[3] This is the most important tax incentive for the corporate sector where government provides tax deductions based on depreciation of fixed capital assets; companies are allowed to claim higher depreciation compared to depreciations under normal circumstances for a fixed number of years to avail such incentives.

[4] See "Revenue forgone under the Central Tax System:Financial Years 2010-11 and 2011-12", Union Budget 2012-13, Statement of Revenue Forgone, p.25.

[5] Effective Tax Rate (ETR) is a measure of actual tax payable from an industry relative to its Profit BeforeTaxes(PBT). The lower ETR reflects companies are paying less tax relative to their profits.More formally, this is the ratio of total taxes paid (calculated for a particular sector/companies) to total profit (profit before taxes). In total taxes paid, surcharge and education cess are included, but dividend distribution tax (DDT) is excluded. It is expressed as a per centage. Following is the standard formula for calculating ETR.

ETR= [{(Total taxes paid by a company+surcharge+education cess)-Dividend Distribution Tax}/Total Profit before Taxes]*100

A disturbing fact is that the effective tax rate[5] for Diamond cutting businesses and Software Development Agencies is at 19.32 per cent and 19.05 per cent respectively which are the lowest among other sector and industries.[6]

- There is a need to examine thoroughly the justifications for the tax exemptions / concessions given in the Special Economic Zones (SEZs). It has been argued that the SEZs have actually turned into real estate zones instead of serving their primary objectives. The Parliamentary Standing Committee on Commerce has criticized the government for not establishing industries in almost half

Table 2: Tax Exemptions for Private Sector Businesses

Nature of Tax Exemptions	Revenue Forgone (in Rs. Crore) [in 2010-11]	Projected Revenue Forgone (in Rs. Crore) [in 2011-12]
Deduction of export profits for Units located in SEZs	7,432	8,153
Accelerated Depreciation	33,243	36,468
Diamond and Gold (precious stones &jewellery)	49,164	57,063
Deduction of Profits of STPI Units Exportables	7,839	NIL(*The deduction has been phased out after 31.3.2011.)*
Deduction of profits of undertakings engaged in generation, transmission and distribution of power	7,581	8,316
Mineral fuels and Mineral Oils	41,200	58,190

Source: Statement of Revenue Forgone, Union Budget 2012-13, GoI.

[6] See "Revenue forgone under the Central Tax System:Financial Years 2010-11 and 2011-12", Union Budget 2012-13, Statement of Revenue Forgone, p.32-38.

[7] "Real estate biz becomes prosperous in guise of SEZ: Par Panel"(1 May, 2012) Economic Times, URL: http://economictimes.indiatimes.com/news/economy/infrastructure/real-estate-biz-becomes-prosperous-in-guise-of-sez-par-panel/articleshow/12951165.cms. And also see, the URL: http://www.track2realty.com/parliamentary-panel-finds-sezs-haven-for-realty-prosperity.

> the SEZs set up since 2006 and giving the land to realtors, diverting fertile land of farmers.[7] The Committee said that though land was acquired for SEZs, no industries have been set up in such lands; only 154 SEZs have become operational out of 389 notified, instead real estate business has become prosperous in the guise of SEZs.

Several gems and jewellery units (which import European designer jewellery, targeted at the burgeoning market of wealthy Indian consumers, without paying any import duty) are taking advantage of the sops offered in SEZs. Reportedly, some gems and jewellery units operating in the Noida SEZ in the National Capital Region and Santacruz Electronics Export Processing Zone in Mumbai have been accused of abusing the license to import raw materials free of duty.[8] There are even cases of designer jewellery being imported as raw materials when the exported items were ball bearings.[9] The government needs to recognize such glaring loopholes and address these with appropriate revenue collection measures.

Concluding Remarks

Exemptions should be minimised and carefully designed. Often the nature of exemptions is not socially equitable. In case of corporate taxes, the tax base remains low due to a variety of exemptions and deductions. Regarding indirect taxes, customs and excise remains still a major concern. Moreover, exemptions should be justified with sound social and economic reasons. Certain allowances in case of Tax Holidays and depreciation allowances (accelerated depreciation in particular) should be reviewed. The cost-benefit analysis for each type of exemption is imperative. Tax bases can be increased by imposing a small amount of tax on entirely unproductive activities and assets[10] (for instance, wealth, property and gift tax regime can be reviewed).

---

[8] "SEZ imports under scanner"(Jan 27, 2010), The Financial Express, URL: http://www.financialexpress.com/news/sez-imports-under-scanner/571898/. For a relatively elaborate discussions on this, see "Special Economic Zones: Profits At Any Cost" (22 October, 2007) by C.R. Bijoy, Centre for Education and Documentation, URL:http://www.doccentre.net/Tod/SEZs-Profits-At-Any-Cost.php.

[9] "Abuse of duty-free imports may lead to tighter regulation of SEZs"(Jan 27, 2010); The Financial Express, URL: http://www.financialexpress.com/news/abuse-of-dutyfree-imports-may-lead-to-tighter-regulation-of-sezs/571868/2

[10] For instance, there is a plan by government to introduce commodity transaction tax (CTT) in commodity trading. For details see, "Govt plans tax on commodity trading"(February 2, 2012) Times of India, URL: http://timesofindia.indiatimes.com/business/international-business/Govt-plans-tax-on-commodity-trading/articleshow/11722001.cms.

Examining the Vodafone Case

Pooja Rangaprasad*

In a landmark judgment in January 2012, a three judges bench of the Supreme Court of India, in the case of *Vodafone International Holdings BV vs Union of India*, set aside the Bombay High Court judgment, which had required Vodafone to pay capital gains tax worth Rs.11,000 crore to the Government of India for a transaction that had seen the company acquire 67 per cent stake in Hutchison Essar (a mobile phone operator in India) in 2007. Vodafone, the second largest telecom operator in India, had challenged the tax bill over its $ 11.5 billion (Rs. 55,000 crore) deal to buy Hutchison Whampoa Ltd.'s Indian mobile business in 2007, and appealed to the Supreme Court (SC) after losing the case in the Bombay High Court.

Vodafone's main argument was that the Government of India cannot levy taxes because the transaction was made between non-Indian companies outside the country; the deal was between Vodafone International Holdings BV - a Dutch subsidiary of Vodafone - and CGP Investments Ltd., a Cayman Islands company, which held the Indian telecom assets of Hutchison. Indian tax authorities, however, held that the transaction was taxable because the assets acquired by Vodafone are based in India; the government had argued that Vodafone had failed to deduct or withhold capital gains tax at the time of purchase. Capital gains tax is imposed on the profit earned from selling an asset.

The SC, referring to the relevant sections in the Income Tax Act, held that the capital gain arising on transfer of shares of a foreign company is not liable to tax in India even though the principal asset of the foreign company is the underlying shares of an Indian company; it also directed the IT department to return Rs.2,500 crore deposited by Vodafone, in compliance of its interim order, within two months along with 4 per cent interest.

Implications of the verdict- Contested views and opinions

Beyond the loss of revenue, the fallout of the ruling was larger as a number of multinationals operating in various sectors such as SABMiller (breweries), Sanofi Aventis (drugs), Kraft Food and Vedanta (oil) had entered into acquisition deals similar to that of Vodafone. "*This settles a prolonged litigation that had created a*

Source: Times of India, KPMG & NDTV Profit

---

*Pooja Rangaprasad works with the Centre for Budget and Governance Accountability (CBGA) as Programme Consultant (Advocacy & Outreach) focusing on tax-related issues. Her areas of interest include taxation treaties and international developments in the tax arena.

[1]http://articles.economictimes.indiatimes.com/2012-01-20/news/30647139_1_capital-gains-tax-vodafone-stake-sale

[2]http://articles.economictimes.indiatimes.com/2012-01-20/news/30647139_1_capital-gains-tax-vodafone-stake-sale

lot of uncertainty for foreign companies having similar structures who had entered into or were proposing to enter into similar transactions," said Sandeep Ladda, executive director with Pricewaterhouse Cooper (PwC) India[1].

India Inc. and various chambers had lauded the SC ruling upholding the law which would send positive signals to foreign investors and be beneficial for foreign direct investment (FDI) in the long run. As per FICCI secretary general Rajiv Kumar, "Stability of institutional processes is an important requirement for attracting foreign direct investment. This decision will re-inject confidence in cross-border mergers and acquisitions and further augment such investment coming to India.[2]"

But this view has also been contested by many, including the Government of India, which had moved the SC seeking review of the judgment. The government listed 121 grounds, each pointing to an error in judgment, to seek review of the January 20 order and said it was surprised by the apex court's decision to give relief to Vodafone on the ground that its offshore transaction was a structured foreign direct investment (FDI) into the country when in reality not a single rupee came as investment into India. In its 101-page review petition, the Ministry of Finance through its Secretary and the Assistant Director of Income Tax has noted that the FDI policy was in no way under challenge or scrutiny in the instant case and could not have been so as the FDI and interpretation of taxing statutes operate in two different realms.

To cite from the petition, "The apex court failed to appreciate that the instant case did not involve any inflow of monies into India because the sale consideration was admittedly paid outside India by VIH, a British Virgin Island company, to HTIL. Therefore, it was not a case of FDI into India."

Tax Justice Network notes that if the SC had "*ruled that India should have been able to levy those taxes, the corporations would all have huffed and puffed about the investment climate, but at the end of the day they would still get their foreign investors slavering to be the investors to come in*" because they know that the Indian telecommunications market is a goldmine[3].

Changes made to the tax laws- Demystifying the retrospective amendments debate

Retrospective amendment of Section 9 and Section 2 of the Income Tax Act, 1962 introduced in the Finance Bill 2012-13, which clarify the definitions of 'capital assets' and 'transfer', will ensure that cross-border transactions like the Vodafone-Hutch deal will be taxed. It has been suggested that around Rs. 35,000 crore to Rs. 40,000 crore is at stake from deals similar to the Vodafone deal[4]. Not surprisingly, the proposal led to lobbying by the private corporate sector and even the British government on Vodafone's behalf.

As per the IT Act, cases beyond six years cannot be reopened and the Union Finance Minister has said that the current amendments are only '*clarificatory*' in nature to state the legislative intent of certain provisions of the Income-Tax Act relating to offshore mergers and acquisitions.

The Supreme Court has previously held that an ordinance having retrospective effect is not invalid since there is nothing in the Indian Constitution which prohibits the same[5]. It has been pointed out that retrospective amendment has been unjust and immoral, even if legal. The Supreme Court itself has not entertained the argument about "just and reasonable" when the amendment is otherwise valid (Lohia Machines vs. UOI). There is no morality in law so long as it is not oppressive or confiscatory to such an extent that it violates the fundamental rights in the Constitution[6].

Examples of retrospective tax law amendments, particularly if they are anti-avoidance, are not uncommon. The United Kingdom has also in its Budget for 2012, presented on February 27, introduced retrospective provisions to check the avoidance of corporation tax. Amendment was also made in the UK's Finance Act, 2008, with retrospective effect from 1987 to prevent tax avoidance through entities based in the Isles of Man and Jersey. China, in December 2009, retrospectively introduced a new law (Circular 689) to tax sale of offshore holding companies having underlying Chinese interests by disregarding the intermediary entity in specific circumstances. The law seeks to capture abusive structures aimed at tax avoidance[7].

It is evident that India's move to introduce retrospective provisions to address tax avoidance is in line with the policies followed by other countries. In fact, a mindset that accepts that no active or retrospective efforts can be made against tax havens is backward-looking, out of step with the world's major economies' determination to fix the loopholes in the global financial system and violates the requirements for economic fair play and is contrary to the basic principles of equity, equal opportunity and social justice.

[3]http://taxjustice.blogspot.in/2012/01/vodafone-defeats-india-in-landmark-29bn.html

[4]http://business-standard.com/india/news/with-rs-40k-cr-tax-at-stake-finmin-firmi-t-amendments/472832/

[5]Tabrez Ahmad and SatyaRanjan Swain.Validity of Retrospective Amendments to Indian Taxation Statutes.International Journal of Economic and Political Integration. Volume 1, Number 2: Autumn pp 3-8

[6]http://www.business-standard.com/india/news/vodafone-retrospective-more-sinned-against-than-sinning/470574/

[7]http://articles.economictimes.indiatimes.com/2012-04-13/news/31337558_1_tax-sale-tax-avoidance-retroactive-legislation

Importance of taxation policies for social development- Viewing the Vodafone case as part of a bigger debate on tax justice

"*Why should I pay so much tax to the state since most of it goes into private pockets?" becomes a common refrain for the affluent middle class. Tax cuts, therefore, become the order of the day along with expenditure cuts by the state, which is exactly what successive Republican administrations did in the United States. Since the tax cuts are for the rich and the affluent middle class, while the expenditure cuts are for the poor, this has a directly regressive effect on income distribution*[8]".- Prabhat Patnaik[9]

While the subject of taxation may seem technical and one that would mostly interest lawyers, chartered accountants and corporate/business sector, fair taxation policies are at the core of addressing poverty and inequality. Comparingthe Tax-GDP ratio across countries, it is evident that India's Tax-GDP ratio at 14.73 per cent[10] is much less both in absolute terms as well as in relative terms compared to the other countries.

The regressive nature of India's tax regime further highlights the need to increase reliance on direct taxes. A Study conducted in 2008 in Hyderabad has shown that the poorest sections comprising beggars, rickshaw pullers etc paid Rs. 336.5 (or 10.16 per cent) of their total monthly expenditure of Rs. 3309 as indirect taxes[11]. On the other hand, estimates show that direct taxes (corporate tax and income tax) account for only one third (37 per cent) of total tax collection while indirect taxes (which affect rich and poor alike) account for the remaining two-third (63 per cent)[12] of India's total tax revenue.

Finally, even as big corporations and business houses continue to complain about the taxation amendments, it is important to ask whether expecting or encouraging 'investors to transparently participate in the taxes and above-ground economic life of a modern economy, instead of the legally-uncertain, secretive shadow world of tax havens and offshore territories'[13] should be considered and contested as harsh or excessive?

---

[8]http://www.frontlineonnet.com/fl2819/stories/20110923281902800.htm

[9]Prabhat Patnaik held the Sukhamoy Chakravarty Chair at the Centre for Economic Studies and Planning, Jawaharlal Nehru University, New Delhi.

[10] Indian Public Finance Statistics, 2010-11, Govt. of India
[11] Study on Indirect Taxes Paid by the Poor: Study by COVA in Hyderabad City- 2008
[12] Indian Public Finance Statistics, 2010-11, Govt. of India
[13] http://www.business-standard.com/india/news/not-backward-looking/468103/

A Note on White Paper on Black Money

Pooja Rangaprasad*

The 97 page document, released by the Ministry of Finance (Department of Revenue) in May 2012 in response to the demands of the opposition due to the spate of scams in the recent past, is an interesting read to get a sense of the overall mechanisms in place and a consolidated overview of various strands of information related to black money. But there is not much in terms of specifics and the report has been criticised for being little more than a mere 'research report'[1]. What is particularly of concern is the omission of key steps required towards addressing the menace of black money with respect to transparency and the support for problematic recommendations.

One of the strategies for curbing generation of black money proposed is the rationalization of tax rates, using the Laffer curve thesis to support this argument, which is incredibly problematic. Quoting from the report, '*the higher the tax rate, higher is the disincentive against tax compliance and greater the propensity to generate black money. Thus reducing tax rates, particularly the maximum marginal rates of progressive taxes, can increase tax revenue*'. This idea that cutting tax rates will increase revenue has been debunked repeatedly[2]. Richard Murphy, an economist and author of The Courageous State, has criticised this idea in the past as a statement of 'right wing dogmatic belief' for which there is no evidential support[3]. In an already-regressive taxation system,proposing a reduction in maximum marginal rates of progressive taxes is unacceptable.

On the release of the White Paper, apex industry chambers were one of the few to hail the report[4]. Federation of Indian Chambers of Commerce and Industry (FICCI) particularly welcomed the inclusion of its suggestion for India to enter into a special agreement with Switzerland similar to the UK-Swiss agreement. This agreement which allows revenue sharing at the cost of disclosing identity has come under sharp criticism from various quarters in the UK for perpetuating the Swiss banking secrecy and essentially permitting tax evasion to take place. It is perhaps not surprising that industry chambers are pushing for a similar agreement as it would do nothing to address the issue that is at the core of black money - secrecy, one that Switzerland provides. The focus needs to be less on bringing back the money stashed abroad and more on the loopholes that allows the flight of capital, like banking secrecy, to be closed definitely. So India following the example of the UK-Swiss agreement is dangerous and counter-productive to the intent of addressing the issue of black money.

One of the biggest shortcomings in its recommendations to address the issue of black money is the absence of specific measures towards increasing transparency and accountability. For instance, there is no indication that details of trusts, company ownership details and company accounts will be put on public record. The lack of easy access to this crucial information contributed to India being ranked at 25th position on the 2011 Financial Secrecy Index developed by Tax Justice Network.

As Prof. Arun Kumar at JNU points out, the White Paper needs to be seen as a political document rather than a technical one as the issue of seriously addressing black money is a question of political will[5].

*Pooja Rangaprasad works with the Centre for Budget and Governance Accountability (CBGA) as Programme Consultant (Advocacy & Outreach) focusing on tax-related issues. Her areas of interest include taxation treaties and international developments in the tax arena.

[1]http://www.hindustantimes.com/business-news/ColumnsBusiness/Is-Pranab-s-white-paper-on-black-money-an-exercise-in-futility/Article1-862270.aspx

[2]OPTIMAL TAXATION OF TOP LABOR INCOMES: A TALE OF THREE ELASTICITIES by Thomas Piketty, Emmanuel Saez, Stefanie Stantcheva. National Bureau of Economic Research. November 2011

[3]http://www.taxresearch.org.uk/Blog/2012/03/29/hmrc-now-subscribes-to-la-la-laffer-and-to-the-idea-that-companies-dont-pay-tax/

[4]http://www.thehindubusinessline.com/industry-and-economy/economy/article3446484.ece

[5]http://www.thehindu.com/opinion/lead/article3456558.ece?homepage=true

Budget and Policy Tracking

Neha Hui*

I. The Backdrop

The last financial year (2011-12) of the 11th Plan saw the documentation of the Approach Paper to the 12th Five Year Plan by the Planning Commission, which indicates the government's commitment to the agenda of accelerated liberalisation and reflects its priorities towards the social sector. India's recent high growth trajectory is a much celebrated aspect of the planning process and the 12th Plan seems to view this with uncritical euphoria. Like in the case of the previous plan, the 12th Plan Approach Paper indulges in the rhetoric of "inclusiveness" without effectively defining or explaining how the plan is going to be inclusive. The purported high growth is perceived to be the source of revenue to fund development expenditure. However the question is: How will the government garner the required resources in a socially equitable manner, without raising indirect taxes (and increasing the burden of the lower income groups) while keeping inflation in check? In other words, what would be a more progressive way of raising revenue for the development process?

The commitment of the policy makers to privatisation and liberalisation has often meant that the provisions of universalisation of entitlements have to face cutbacks and rollbacks on the grounds of insufficient funds. Worse still, while the social sector has to endure cuts in benefits and entitlements, corporate groups are granted increased subsidies and exemptions. Over and above the exemptions to the corporate sector is the rampant growth of tax evasion, especially among the business community, with the government and judiciary ill-equipped to tackle the problem.The significance of tax revenue is even more crucial in the era of the Fiscal Responsibility and Budget Management (FRBM) Act, which has invited criticism not only from progressive economists, but also from several state governments.

This is because it has sought greater expenditure compression by mandating elimination of revenue deficit and significant reduction in fiscal deficit through the Union and state budgets. Thus, deficit financing is no longer an option for the government; increasing revenues is. At the same time, increased pressure from various quarters owing to rising poverty and the lack of basic entitlements has compelled the Government of India to focus more attention on social sector schemes – it cannot afford to ignore the demands of the public for universalisation of education, healthcare and food security.This calls for some serious rethinking of government finances. For example, financing of the Food Security Bill, 2011, (as and when it becomes a legislation) would involve an additional Rs.3.5 lakh crore, with funds required to raise agriculture production, create storage space and publicity, according to one estimation.

This issue of *Budget and Policy Tracking* examines important bills introduced and debated during the Monsoon Sessionand Winter Session of Parliament 2011-12 and Budget Session 2012-13. Apart from Demands for Grants and legislative bills, the discussions in the Monsoon Session centred on issues pertaining to terrorism, corruption, Lokpal Bill and the problems

Vidhan Sabha Elections 2012

In March 2012, Assembly elections were held in Goa, Manipur, Punjab, Uttar Pradesh and Uttarakhand. The Bharatiya Janata Party came to power in Goa (with an ally) and Himachal Pradesh while the Shiromani Akali Dal (in alliance with BJP) formed government in Punjab. The Congress and allies won the assembly elections in Uttarakhand Indian National Congress while the Samajwadi Party swept the polls in Uttar Pradesh.

State	Total Number of Seats	Party	Seats won
Goa	40	Bharatiya Janata Party + Ally[a]	23
		Indian National Congress	9
Manipur	60	Indian National Congress	42
		Trinamool Congress	7
Punjab	117	Shiromani Akali Dal + Ally[b]	68
		Indian National Congress	46
Uttarakhand	70	Indian National Congress +Allies[c]	39
		Bharatiya Janata Party	31
Uttar Pradesh	403	Samajwadi Party	224
		Bahujan Samaj Party	80

Note- a: Maharashtra wadi Gomantak Party

b: Bharatiya Janata Party

c: Bahujan Samaj Party, Uttarakhand Krantikari Dal and Independents

*Neha Hui was till recently working with the Centre for Budget and Governance Accountability (CBGA) as a Research Consultant focusing on tax-related issues. She is a recipient of the Commonwealth Scholarship and is planning to pursue her doctoral studies in the UK.

Monsoon and Winter Sessions 2011 and Budget Session 2012 at a Glance

The Monsoon Session of Parliament had 26 sittings, starting August 1, 2011 and both Houses were adjourned *sine die* on September 8, 2011. Thirteen bills were introduced in the Houses and ten were listed for consideration and passing.

Bills passed during the Monsoon Session include:

- The Juvenile Justice (Care and Protection of Children) Amendment Bill, 2010

Bills introduced during this session that are still pending include:

- The Land Acquisition, Rehabilitation and Resettlement Bill, 2011
- The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Bill, 2011
- The Lokpal Bill, 2011

Pending Bills from earlier sessions include:

- The Direct Taxes Code Bill, 2011
- The Constitution (110thAmendment) Bill, 2009 (which reserves 50 per cent seats in Panchayats for women)
- The Right of Children to Free and Compulsory Education (Amendment) Bill, 2010
- The Constitution (108thAmendment) Bill, 2008 (Women's Reservation Bill)
- The Communal Violence (Prevention, Control and Rehabilitation of Victims) Bill, 2005

The Winter Session of Parliament sat from November 22, 2011, and was adjourned *sine die* on December 29. The Lok Sabha and Rajya Sabha had 24 sittings each. Thirty bills were introduced in the session and 17 were listed for consideration and passing.

Bills listed for consideration and passing include:

- The Lokpal Bill, which was withdrawn from the Lok Sabha on December 2011
- The Constitution (110th Amendment) Bill, 2009, which proposes to reserve 50 per cent of seats in Panchayats for women and Scheduled Castes (SCs) and Scheduled Tribes (STs)
- The Marriage Laws (Amendment) Bill, 2010
- The Protection of Children from Sexual Offences Bill, 2011
- The Right of Children to Free and Compulsory Education (Amendment) Bill, 2010

Bills listed for introduction, consideration and passing include:

- The National Food Security Bill, 2011
- The Citizen (Amendment) Bill, 2011

The Budget Session was commenced between March 12 and 22, 2012 and had had 35 sittings in both the Lok Sabha and Rajya Sabha. 17 Bills were introduced, out of which 12 were passed.

These included:

- The Finance Bill, 2012
- The Protection of Children from Sexual Offence Bill, 2011
- The Small Investment Development Bank of India (Amendment) Bill, 2012
- The Microfinance Institution (Development and Regulation) Bill, 2012
- The Regulation of Birth and Deaths (Amendment) Bill, 2012

Source: PRS Legislative Research website of Tamils in Sri Lanka while those during Winter Session included inflation, the agrarian crisis, Lokpal Bill and environmental concerns relating to the River Ganga and the Himalayas. Parliament also witnessed heated debates on the issue of inflation, black money, Telangana and FDI in the retail sector. Most of the Budget session in both houses was spent in discussing the Railway and General Budget, but other issues including civil aviation, food grain storage problem, exploitation of River Ganga and the Himalayas and reservations were also discussed.The focus of this piece would be on policies relevant to revenue collection and finance development: debates revolving around revenue channels, loss of revenue and the situation with regard to plugging leakages in the economy are discussed; and, bills dealing with taxation and the laws directed at tackling the black economy are brought under consideration. It will examine the present situation regarding tax revenue, especially revenue foregone; review the black money situation in the country; scrutinise some legislations on the issue of revenue generation debated in both Houses of Parliament; and give an overview of important legislations concerning social security.

Vidhan Sabha Elections 2012

In March 2012, Assembly elections were held in Goa, Manipur, Punjab, Uttar Pradesh and Uttarakhand. The Bharatiya Janata Party came to power in Goa (with an ally) and Himachal Pradesh while the Shiromani Akali Dal (in alliance with BJP) formed government in Punjab. The Congress and allies won the assembly elections in Uttarakhand Indian National Congress while the Samajwadi Party swept the polls in Uttar Pradesh.

II. India's Tax Revenue Situation

India's tax revenue is very low compared to international standards, as its tax regime provides for numerous deductions, exemptions and tax incentives. The tax-GDP ratio in Scandinavian countries is close to 50 per cent and about 30 per cent in other European countries while it is less than 15 per cent in India. This is very low in comparison with other developing countries like South Africa, Russia, Turkey and Brazil, which have tax-GDP ratios of more than 30 per cent, and Argentina, Bolivia and Namibia, which have ratios of between 25 and 30 per cent. Available statistics show that the revenue foregone due to various exemptions and incentives provided under the Central taxation system in 2009-10 was 77.3 per cent of what was actually collected while in 2010-11, the potential revenue could have been double the actual collections.Clearly, there is an urgent need to re-examine the legal framework of India's taxation system.

III. Black Money

Though there are no accurate estimates, there is no doubt that India has a large, complex and intertwined underground economy that severely affects planning and monetary and fiscal policies. Arun Kumar (2011) estimates the size of India's parallel economy to be approximately half the size of the legal economy and affecting about 97 per cent of the population. This has led to a massive loss of revenue for the government, spirallinginflation and job loss. In the face of increasing inflationary trends and ever since becoming a full-fledged member of the inter-governmental Financial Action Task Force (FATF) – responsible for setting global standards on anti-money laundering (AML) and combating financing of terrorism (CFT) – the Indian government decided to constitute committees to examine ways and means to strengthen laws to curb generation and illegal transfer of black money and its recovery.

In the Union Budget 2011-12, the Finance Minister announced a "***Five-fold strategy to be put into operation to deal with the problem of generation and circulation of black money"***. The strategy envisages joining the global crusade against black money, creating an appropriate legislative framework, setting up institutions for dealing with illicit funds, developing systems for implementation and imparting skills to the labour power for effective action. In March 2011, the Ministry of Finance commissioned three national Institutes to do an in-depth study on the magnitude and effect of money laundering in the country. In addition, a committee headed by the Chairman, Central Board of Direct Taxes (CBDT) has been set up in August 2011 to examine the existing legislative framework with respect to the generation of black money and consider the possibility of strengthening laws that deal with money laundering in India.

IV. Finance Bill 2012

Finance Minister Pranab Mukherjee introduced the Finance Bill, 2012 in the Budget Session that commenced on March 16, 2012. Some positive aspects of the Bill from the point of revenue generation as well as social justice include the provisions for Retrospective Amendments, Tax Residency Certificates and General Anti-Avoidance Rules (GAAR).

The provision for retrospective amendments is a step forward as it clarifies definitions of "capital assets" and "transfer"that will ensure that cross-border transactions like the Vodafone-Hutch deal are taxed. The Supreme Court had ruled in favour of Vodafone in January and held that the government has no jurisdiction over transactions that take place outside the country. These amendments will now bring (under the jurisdiction of Indian tax authorities) all cross-border transactions that involve indirect transfers of shares whose underlying assets are located in India. It has been estimated that around Rs.35,000 crore to Rs.40,000 crore is at stake from deals similar to Vodafone. The importance of this revenue to social development can be noted against the backdrop of recent news reports that the tab for releasing foodgrains to make way for new arrivals adds up to approximately Rs.25,000 crore.

The Finance Bill also seeks to mandate Tax Residency Certificates (TRCs) in a prescribed manner aimed at checking misuse of treaties such as the double tax treaty (DTT) with Mauritius. The memorandum to the Finance Bill clarifies that submission of TRC is a necessary but not a sufficient condition for availing benefits of the treaties. It gives the tax authorities power to overlook the TRCs and demand further proof of commercial substance. This may help plug the loophole in the India-Mauritius Treaty that enables Capital Gains Tax to be accrued in the country where the company is resident (i.e., Mauritius, which has zero Capital Gains Tax) and thus escape being taxed altogether.

It also seeks to introduce GAAR to codify "substance over matter". This will ensure that the real intention of the parties, the effect of transactions and the purpose of an arrangement is taken into account for determining the tax consequences irrespective of the legal structure superimposed to camouflage the real intent and purpose. Invoking GAAR requires the permission of the Commissioner before it is referred to an Approving Panel. Although the procedure and working of the panel will be administered through a subsequent legislation, the Finance Bill provides that the panel will comprise a minimum of three members (and they have to be officers of the rank of Commissioner and above). The provisions for retrospective amendments and GAAR are, however, in danger of getting watered down due to the demands of the industry/business lobby.

There are some aspects of the Bill that need to be critically looked into. For example, it recommends lowering of the Securities Transaction Tax (STT). The underlying principle of levying STT is to "curb purely short-term speculation by big operators, FIIs and fund managers without significantly affecting the long-term investors"[1]. Short-term trading is considered to be one of the major factors responsible for market volatility and the tax ensures stability in the financial markets. But the reduction in Securities Transaction Tax proposed (from the existing 0.125 per cent to 0.1 per cent) will have extensive implications for revenue and there are apprehensions that it will encourage speculative short-term trading. It has been estimated that a 0.25 per cent STT will generate tax revenue of Rs.37.5 crore every day and Rs.9,375 crore every year[2]. Given the seriousness of India's low tax-GDP ratio, the rationale for reducing STT is questionable.

In a society deeply affected by inequality such as India, taxation is also linked intrinsically to the issue of social justice. The proposals in the Finance Bill need to be viewed against the broader framework of the country's tax structure and socio-economic reality to ensure that the taxation policies are just and become an effective instrument for creation of an egalitarian society instead of remaining a bulwark for increasing economic disparities and social discord.

V. Bills Introduced in Parliament on the Issues of Revenue Generation

Against the backdrop of increasing corporate exemptions, pressure from various quarters to make taxation compliant with international standards and increasing costs of financing development, the Finance Ministry is keen to widen the tax base. The **Direct Tax Code (DTC) Bill, 2010** that seeks to replace the Income Tax Act, 1961 had been formulated given this context. The Bill, introduced in Parliament in August 2010 and set to become effective from 2013, is under scrutiny of the Parliamentary Standing Committee. The rationale behind its introduction is to broaden the tax base and be able to tackle tax avoidance by improving tax information exchange. The DTC Bill however proposes higher tax brackets as compared to the existing limits of the Income Tax Act, and this may result in revenue losses. Rao (2010) estimated that the tax liability would decrease by a third or more of the present, and over 97 per cent of the current taxpayers would be paying tax at just 10 per cent. Further, the proposed legislation does not include the Income tax benefit that women taxpayers were entitled to in the past.

The new Code proposes to reintroduce wealth tax, levied at one per cent of taxable assets. While this is a positive move in that it would discourage wealth concentration, the rate at which the tax is proposed seems more like a symbolic gesture rather than actual commitment towards distributive tax policies. It also proposes to treat savings through a system of Exemption-Exemption-Tax (EET). The level of exemption under the new tax regime would be increased from Rs.1 lakh to Rs.3 lakh but the list of eligible investments for exemptions would be significantly reduced. While savings and returns from these savings would not be taxed, any withdrawal for the purpose of consumption would be. This is likely to impact the lower income category and senior citizens, as emergency expenditures would be liable for taxation.

The DTC replaces the term "capital asset" as used under the existing Act with the term "investment asset". An investment asset includes non-business capital assets, securities held by foreign institutional investors (FII) and any undertaking or division of a business.The Bill had originally proposed major overhaul in the area of capital gains differentiating between short and long term capital gains. However, there have been substantial changes between the first and the second version of the DTC, and the later version dilutes the scope of taxing capital gains. The Bill moots inclusion of short-term capital gains from all assets, including equity or equity-oriented funds, as income and taxing these at applicable rates, which is half the rate of income (5, 10 and 15 per cent). Long-term capital gains are to be

[1]Singh, Kavaljit, Tax Financial Speculation: The Case for a Securities Transaction Tax in India, Conference Papers, Halifax Initiative, Vancouver, Canada, October 4-6, 2001

[2] Ibid

omitted from any amendment as per the later version.

A welcome feature under the draft code is introduction of the statutory General Anti-Avoidance Rules (GAAR). The anti-avoidance provisions have been included in the DTC after years of deliberation following the Supreme Court's verdict in 2004 in the Azadi Bachao Andolan case[3]. Chapter XI of the draft DTC states that any transaction through overseas transfer of shares will be liable to tax if the underlying value in India is more than 50 per cent. Introduction of this law is especially significant in the context of the apex court's recent ruling in the Vodafone case (as discussed in one of the articles). The purpose of GAAR is to ensure that the real substance of the transaction and real intention of the parties are not camouflaged by the complexities of the legal structure within which it takes place.

A common mode of evading taxes is through abuse of the Double Taxation Treaties (DTT) with countries, in particular with Mauritius. As per the Income Tax Act, 1961, Non-Resident Indians (NRIs) are obliged to pay tax on incomes earned in India, which Foreign Institutional Investors (FIIs) circumvent by citing the DTT with Mauritius. According to the treaty, a company will be taxed only in the country where it is domiciled. To avoid paying taxes, many FIIs based in other countries and operating in India claimed Mauritian domicile by virtue of being registered there under the Mauritius Offshore Business Activities Act (MOBA), which however does not give the companies the right to acquire property, invest or conduct business in the island nation. **The Prevention of Money Laundering (Amendment) Bill, 2011**, is an attempt at curbing this problem and is in line with the recommendations of FATF. The Bill is an amendment to the Prevention of Money Laundering Act, 2002 (PML Act) (15 of 2003), which was enforced in 2005.

The main purpose of the Act was to "prevent money laundering and to provide for attachment, seizure and confiscation of proceeds of crime obtained or derived, directly or indirectly from money laundering and for matters connected therewith or incidental thereto" (PML Act 2002). In an effort to broaden the reach of the Act, the Bill expands the definition of offence under money laundering to include activities like concealment, acquisition, possession and use of proceeds of crime. To make the act more comprehensive, the Bill proposes to introduce the concept of "corresponding law" to link the provisions of Indian law with the laws of foreign countries. This reflects a positive change in the attitude of the legislature and it would provide scope for reviewing treaties like DTT. The Bill also adds the concept of "reporting entity", which would include a banking company, financial institution, intermediary or a person carrying on a designated business or profession.

The **Unlawful Activities (Prevention) Amendment Bill, 2011** has also been drafted to meet the requirements set by FATF on combating money laundering and terrorist financing. The Bill was introduced in the Lok Sabha in December 29, 2011. Though it has potential for curbing money laundering and terrorism financing, the Bill has been criticised for doing so at the cost of the fundamental rights of citizens. It legislates that groups may be banned for five years before judicial review and gives the government the authority to deprive individuals from property prior to convicting them of any of the crimes. It also has grey areas which could lead to its abuse – to permit prosecution of mass organisations and grass-roots organisations allegedly associated with the banned groups.

The **Lokpal Bill, 2011** revolving around corruption and linked to the problem of black money was at the centre of heated debates during the Monsoon and Winter sessions in Parliament. The 2011 version of the bill is an improvement over the one in 2010, which had drawn flak from civil society and the media for being a "half-hearted effort"at tackling corruption. Only Ministers and Members of Parliament could be prosecuted within the scope of the earlier version of the proposed legislation, leaving out government officers. The newer Bill is designed to ensure a decentralised and citizen-friendly mechanism to redress public grievances. Related to this, **The Public Procurement Bill, 2012** drafted by the Department of Expenditure, Ministry of Finance was introduced in Budget Session 2012. It seeks to regulate public procurement in order to ensure 'transparency, accountability and probity' in the procurement process. The Bill applies to government contracts above Rs.50 lakh and proposes imprisonment of up to five years for any public servant found guilty of engaging in corrupt practices. In order to ensure greater transparency and accountability in the bidding process, the Bill seeks to create a central public procurement portal and an independent mechanism for grievance redressal. Considering there is no overarching legislation governing public procurement, this is a welcome Bill that will hopefully achieve its aim of maintaining 'integrity and public confidence' in the public procurement process.

VI. Other Bills Pertaining to Social Security discussed in Parliament

The **Micro Finance Institutions (Development and Regulation) Bill, 2012** was introduced in the Lok Sabha in the Budget Session of Parliament. The main aim of the bill is to regulate and develop micro finance institutions (MFIs). The proposed law gives the central government authority to create a Micro Finance Development Council with officers from different Ministries and Departments. The Centre would also have authority to form State Micro Finance Councils which will be responsible for coordinating the activities of District Micro Finance Committees and reviewing

[3] See Bhushan, p. (2012) 'Capital Gain everyone else loses'. The Hindu, February 23.

MFIs in their states. For regulation of microfinance institutions, the proposed law requires that all MFIs obtain a certificate of registration from the RBI. The applicant needs to have a net owned fund of at least Rs.5 lakh. The RBI would also need to be satisfied by the management of the MFI. The Bill proposes to further restrict MFIs by making it mandatory for them to create reserve fund with RBI which may specify a per centage of net profit to add to this fund. The MFI will not be able to appropriate from this fund unless specified by the RBI. MFIs will also be required to provide an annual balance sheet of accounts and details of their activities to RBI. The RBI is also responsible for grievance redressal and can impose monetary penalty up to Rs. 5 Lakh for not adhering to the Bill's provision. The purpose of this Bill is to check the nature of MFI and control bad investments and misappropriation of funds and corruption. However, the proposed Act would increase bureaucracy in the process and could exclude very small entrepreneurs and investors as dealing with such bureaucratic process would require money and expertise that may be a prerogative of better off people.

Another related Bill that was tabled in the Budget session by the Finance Minister Pranab Mukherjee is the **Small Industries Development Bank of India (Amendment) Bill, 2012** which seeks to amend the Small Industries Development Bank of India Act, 1989. It would allow sectors including floriculture, tourism, restaurants and entertainment industry to access loans from the Small Industries Development Bank of India (SIDBI). The Bill proposes to widen the scope of industrial concerns and aims to give more authority to the Board of Directors of SIDBI to decide investment limits of the concerned industries. The Bill also seeks to empower the SIDBI to confiscate mortgaged property in case of default in repayment of loans and advances. **The National Co-operative Development Corporation (Amendment) Bill, 2012** will allow the Corporation to extend loans to 'producer companies' - entities run by farmers to sell or market their agricultural and related products. The rationale for the Bill, as envisaged in the text of the bill, is that the producer companies can play a major role in improving the livelihood of primary producers and boosting growth of rural economy.

One of the most important social security bills debated in Parliament was the **National Food Security Bill, 2011** introduced in the Lok Sabha by Minister for Consumer Affairs, Food and Public Distribution K.V. Thomas. It aims to provide food and nutritional security to the poor through specific entitlements for certain groups." In the case of non-supply of foodgrains or meals to persons entitled under the Bill, such persons shall be entitled to receive a food security allowance from the state government," the draft Bill states. Various aspects of the bill have been criticised by civil society groups and academics. The provision of food allowance instead of access to food has been described by the Right to Food Campaign as furthering of the systematic process of "dismantling" the Public Distribution System (PDS) and replacing it with cash transfers. This would not only affect household food security and interfamilial distribution of nutrition but also affect procurement, distribution and storage. The bill has again been panned for not universalising PDS and for the basis of the distinction between "priority" and "general" households, in that there are problems in identification of the categories and also because many deserving households get excluded in the process. Besides, school children, malnourished children and migrant workers are left out of the list of beneficiaries.

The **Land Acquisition and Resettlement Bill** defines compensation, rehabilitation and "public purposes" for which private land can be taken over by the government. For that purpose, the Bill seeks to distinguish between land acquisition, which is forcibly acquiring land from unwilling land owners. It proposes that private companies should provide for rehabilitation and resettlement if they purchase or acquire land, through private negotiations, equal to or more than 100 acres in rural areas and 50 acres in urban areas. Further, whenever the government is requested by such companies to acquire part of an area for public purposes, rehabilitation and resettlement of the affected persons from the area acquired by the government, as well as the land purchased previously through private negotiations will be the liability of the government.The Bill considers as affected families not only those owning the land but also tenants, agricultural or non-agricultural labourers, landless persons, rural artisans or self-employed persons residing or engaging in livelihood in the affected area for five years and deprived of their livelihood. It also envisages rehabilitation of entire communities, consisting of 400 or more families in the plains or 200 or more families in tribal and hilly areas.

The Law Commission has drafted the **Prohibition of Unlawful Assembly (Interference with the Freedom of Matrimonial Alliances) Bill, 2011**to make it unlawful for *khap panchayats*[4] (caste councils) to intimidate or coerce people into matrimonial alliance (which includes a proposed or intended marriage). It comes in the wake of several incidents of "honour killings" and other grave offences committed against those going in for *sagotra* marriages (marrying within the *gotra* i.e., clan or lineage) or marrying outside of caste or religion. The Bill, which is under consideration in Parliament, makes it unlawful for people from congregating together to condemn legal marriage on the ground of alleged dishonour to the community or caste and can result in imprisonment and fine. It also reverses the legal presumption that the accused person is innocent until proven

[4] Khap is a socio-political group defined within considerations of caste and patriarchal hierarchy, usually within a village or cluster of villages. Khap Panchayat is a system of social administration which is parallel to the formal judicial system based on these hierarchies.

guilty. The proposed legislation assumes that anyone participating in such congregation will be presumed to have intended to commit the offence.

A Bill of importance regarding social justice and gender equality that was introduced in the Budget Session, 2012 in the Rajya Sabha by Mr Salman Khurshid, Minister of Law and Justice is **The Registration of Births and Deaths (Amendment) Bill, 2012** which seeks to amend The Registration of Births and Deaths Act, 1969. The Bill seeks to include the registration of marriages within the purview of the Act. The Bill requires all marriages (irrespective of religion) to be registered either under this Act or any other existing Law like Anand Marriage Act, 1909. This Bill has significant potential in curbing child marriage and fake marriages leading to trafficking of women as all marriages have to be registered.

The **Protection of Children from Sexual Offences Bill, 2011** is also currently pending in Parliament. It aims to protect children against offences of sexual assault, sexual harassment, pornography. The proposed act also provides for establishment of special courts for trial of such offences. However, Section 7 of the Bill does not provide for any punishment if the consent for a sexual act has been obtained with a person between the age of 16 and 18. The Bill provides for treating sexual assault as "aggravated offence" when it is committed by a person in a position of trust or authority over the child, including a member of the security forces, police officer, public servant, management or staff at the child's home, hospital or educational institution.

Some important bills, especially pertaining to gender issues, have been pending from earlier sessions of Parliament. These include the **Protection of Women from Sexual Harassment at Workplace Bill, 2010** which sought to ensure a safe environment for working women in both the private as well as the public sector. It proposes the definition of sexual harassment to be according to the guidelines laid out by the *Vishakha vs. State of Rajasthan* (1997) case. When enacted, it would be applicable not only for employers but anyone entering the work space as clients, customers, apprentices, daily wage workers or in ad-hoc capacity. Students, research scholars in colleges/ universities and patients in hospitals have also been covered under the Bill. For redressal of complaints, each employer is required to constitute an internal complaints committee. For employers with ten employees or less, a local complaint committee constituting the district officer is to be formed. A major shortcoming is that domestic workers have not been brought under the purview of the proposed law.

Another pending bill is the **Constitution (110th Amendment) Bill, 2009** seeking to increase the seats reserved for women in panchayats. Article 243D of the Constitution provides that a minimum of one-third of the total number of seats filled by direct elections in the panchayats be reserved for women and the Bill proposes increasing the reservation for women to a minimum of one-half of total seats. The seats may be allotted by rotation to different constituencies in a panchayat. Offices of chairpersons in panchayats should be reserved for SCs/STs and women in a manner to be prescribed by the state legislatures. The reservation should be in proportion to the population of SCs/STs in the state. Also, a minimum of one-third seats should be reserved for women among the total number of offices of chairpersons in the panchayats, the Bill envisages.

One of the most contentious bills pending in Parliament is the **Communal Violence (Prevention, Control and Rehabilitation of Victims) Bill, 2005** which allows a state government to notify an area as communally disturbed and provides it the authority to double the punishment for certain crimes in the notified areas. It also provides for special courts and establishes a system for rehabilitation of victims. The Bill has come under fire from many quarters on various grounds, primarily censured for giving more powers to the Centre and state governments rather than being concerned with the welfare of the survivors of communal and ethnic violence. Public servants are also given extraordinary power under this Bill and there have been concerns regarding misuse and abuse of such power against the interests of the minority community. The Bill also does not recognise newer forms of violence that are considered genocidal in nature and relies largely on the already defined crimes by the Indian Penal Code. Significantly, it ignores the need to acknowledge and deal with gender-based violence inherent in communal situations and prescribe a widespread and macro strategy to provide relief and rehabilitation.

VII. Concluding Comments

The 11th Five Year Plan period was characterised by high levels of growth along with unprecedented rates of unemployment, inflation and poverty. While the United Progressive Alliance government at the Centre has been flaunting the high growth rates, it cannot ignore the social welfare concerns being raised by various quarters. The government needs to focus on development expenditures required to ensure equitable growth and also contemplate how to raise revenue for such expenditure. Raising revenue for development expenditure is even more crucial in the light of the FRBM Act whereby deficit financing is being curbed. Thus, the government needs to focus on channelling the revenues from the growing economy to prioritised expenditures. This would not only raise revenue for social sector development; it would also show their commitment towards ensuring a more egalitarian society.

References

Bhushan, P (2012) 'Legitimising Tax Avoidance' *Economic and Political Weekly* March 3

CBGA (2012) 'Implications of the Supreme Court Verdict in the Vodafone Case for Tax Policy in India: A Background Note'

Chandrashekhar, CP (2011) 'Changing Priorities' *Frontline* October 08-11

Desai, M (2011) 'Land Acquisition Laws and the Proposed Changes' *Economic and Political Weekly* June 25

Kumar, A (2011) 'The Cost of the Black Economy' *The Hindu*, August 20

Panchu, S (2011) 'Lokpal: Where Do We Stand Now, and How We Got Here' *Economic and Political Weekly* October 8

Right to Food Campaign (2011) 'Right to Food' *Economic and Political Weekly* August 13

Rao, M G (2010) Bill on DTC – Baby Steps in Tax Reform, *Business Standard*,September 07

Rao, MG and K Rao (2009) 'Direct Taxes Code: Need for Greater Reflection' *Economic and Political Weekly*, September 1

SAHRDC (2012) 'An International Trojan Horse? Need for Review of UAPA Bill 2011' *Economic and Political Weekly* March 10

Singh, S (2011) 'FDI in Retail: Misplaced Expectations and Half Truths' *Economic and Political Weekly* December 17

ABOUT BUDGET TRACK

A newsletter brought out thrice every year that discusses the budget and policy priorities of the government.

CREDITS

Editorial Team:
Praveen Jha, Subrat Das, Pooja Parvati and Vijay Thappa.

Advocacy:
Bhumika Jhamb, Gyana Ranjan Panda, Kanika Kaul, Khwaja Mobeen Ur-Rehman, Pooja Rangaprasad and Priyadarshini Mohanty.

Research:
Happy Pant, Jawed A. Khan, Manzoor Ali, Narendra Jena, Nilachala Acharya, Pooja Parvati, Prashant Prakash, Saumya Srivastava, Sona Mitra and Sankhanath Bandoyopadhyay.

Circulation & Administration:
Bhuwan C. Nailwal, Harsh Singh Rawat, Sumita Gupta, Tara Rawat and T. K. Shaji.

Illustration:
Vikram Nayak

Layout and Design:
Mayank Bhatnagar

Printing:
Kriti Creative Studio
prakashmadhukar@gmail.com
#9873249374

ABOUT CBGA

Centre for Budget and Governance Accountability (CBGA) promotes transparent, accountable and participatry governance. CBGA has been proactively engaged in tracking public policies and economic issues from the perspective of the poor and the marginalised. At CBGA, we believe that apart from analysing the implications of policy priorities, tracking the implementation of the Government's proposals, important policy initiatives and developments in the economy are crucial to the process of seeking a change in favour of the poor and the marginalised.

CBGA BOARD OF TRUSTEES

CBGA

Centre for Budget and Governance Accountability
B-7 Extension/110A (Ground Floor), Harsukh Marg, Safdarjung Enclave, New Delhi - 110029
Tel: (11) 4920 0400, 4050 4846 (telefax) Email: info@cbgaindia.org Web: www.cbgaindia.org